

DISAPPEARING TAX DOLLARS; WHAT CHANGES ARE NEEDED?

HEARING

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY,
FINANCIAL MANAGEMENT AND
INTERGOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON
GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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DISAPPEARING TAX DOLLARS; WHAT CHANGES ARE NEEDED?

THURSDAY, OCTOBER 3, 2002

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL
MANAGEMENT AND INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:10 p.m., in room 2247, Rayburn House Office Building, Hon Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn and Schakowsky.

Staff present: Bonnie Heald, staff director; Henry Wray, senior counsel; Dan Daly, counsel; Dan Costello, professional staff member; Chris Barkley, clerk; Ursula Wojciechowski, intern; David McMillen, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. HORN. I ask unanimous consent that the subcommittee hearing begin before completion of today's full committee hearing.

I'm sorry that we can't immediately go forward. We'll do the best we can. But the fact is, we've got a situation on the Floor where votes are called about every 5 to 10 minutes. So I'm going to start in on my opening statement until we have to go and cast our votes again. We've already gone through this bit for the last five votes.

A quorum being present, this hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order. Today's hearing is on the important subject of improper payments made by Federal agencies. Each year, the Federal Government wastes countless billions of dollars of the taxpayers on improper payments. Some of these payments result from fraud and waste. Others represent simply mistakes. No matter what the cause, improper payments are a chronic problem that must be stopped.

These improper payments occur for a number of reasons. In some cases, agencies lack appropriate approval structures. Sometimes, the payments are simply not being monitored. And in some cases, there is a widespread circumvention of agency rules and guidelines. When an agency lacks proper controls to monitor payments, it promotes a rubber stamp environment in which payments are made with little or no supporting evidence.

The General Accounting Office has found that the purchase card problems at the Department of Education and the Department of Housing and Urban Development suffer from a lack of adequate internal controls. HUD, the Housing and Urban Development depart-

ment, was unable to provide the GAO, the General Accounting Office, headed by the Comptroller General, with an adequate support for more than \$2 billion in purchase card transactions during fiscal year 2001. The Department of Education was unable to find over \$200,000 worth of computer equipment that employees bought using their Government guaranteed purchase cards.

In addition to the purchase card problem, the General Accounting Office found that HUD's multi-family program is extremely susceptible to improper payments. The GAO discovered that HUD had made payments to multi-family property managers for services that were never performed and for goods that were never received. The GAO also determined that the Department of Education's loan and grant programs are at high risk for improper payments. The Departments could not provide adequate documentation for \$8.5 million in grants that were disbursed over a 26 month period.

As alarming as these numbers are, they are only the tip of the iceberg. The extent of improper payments in the Federal Government is unknown because Federal agencies are currently not required by law to estimate them. According to the GAO, the handful of agencies that do report voluntarily estimate that they make improper payments of about \$20 billion a year. And just today, the Office of Management and Budget has given us an updated estimate of over \$33 billion in improper payments for many of the same programs.

I've introduced legislation, H.R. 4878, The Proper Payments Information Act of 2002, that will require nearly all Federal agencies to begin measuring the extent of this problem. Enactment of this bill would provide a major step toward addressing this wasteful and abusive loss of taxpayers' dollars.

Now I welcome our witnesses today, and I look forward to discussing some strategies to resolve this egregious problem. I now yield for an opening statement to the ranking member, Ms. Schakowsky, the lady from Illinois. I am going to go and vote.

[The prepared statement of Hon. Stephen Horn follows:]

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Opening Statement
Chairman Stephen Horn,
Subcommittee on Government Efficiency, Financial Management
and Intergovernmental Relations
October 3, 2002

A quorum being present, this hearing of the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

Today's hearing is on the important subject of improper payments made by Federal agencies. Each year, the Federal Government wastes countless billions of taxpayer dollars on improper payments. Some of these payments result from fraud and waste; others represent simple mistakes. No matter what the cause, improper payments are a chronic problem that must be stopped.

These improper payments occur for a number of reasons. In some cases, agencies lack appropriate approval structures. Sometimes the payments are simply not being monitored. And, in some cases, there is a widespread circumvention of agency rules and guidelines. When an agency lacks proper controls to monitor payments, it promotes a rubber-stamp environment in which payments are made with little or no supporting evidence.

The General Accounting Office has found that the purchase card programs at the Department of Education and the Department of Housing and Urban Development suffer from a lack of adequate internal controls. HUD was unable to provide the GAO with adequate support for more than \$2 million dollars in purchase card transactions during fiscal year 2001. The Department of Education was unable to find over \$200,000 dollars worth of computer equipment that employees bought, using their Government-guaranteed purchase cards.

In addition to the purchase card problems, the GAO found that HUD's multifamily program is extremely susceptible to improper payments. The GAO discovered that HUD had made payments to multifamily property managers for services that were never performed and for goods that were never received.

The GAO also determined that the Department of Education's loan and grant programs are at high risk for improper payments. The department could not provide adequate documentation for \$8.5 million dollars in grants that were disbursed over a 26 month period.

As alarming as these numbers are, they are only the tip of the iceberg. The extent of improper payments in the Federal Government is unknown because Federal agencies are currently not required by law to estimate them. According to the GAO, the handful of agencies that do report voluntarily estimate that they make improper payments of about \$20 billion dollars a year. And just today, the Office of Management and Budget has given us an updated estimate of over \$33 billion dollars in improper payments for many of the same programs.

I have introduced legislation, H.R. 4878, "The Improper Payments Information Act of 2002," that will require nearly all Federal agencies to begin measuring the extent of this problem. Enactment of this bill would provide a major step toward addressing this wasteful and abusive loss of taxpayer dollars.

Now, I welcome our witnesses today, and I look forward to discussing some strategies to resolve this egregious problem.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman, for holding this hearing. And I thank the witnesses for taking time out of their busy schedules to testify today.

I have worked closely with the chairman throughout this Congress to highlight the lack of fiscal management in the administration. Most of our work has focused on the Department of Defense, and it is clear that DOD is wasting public funds at an alarming rate. I'm pleased that today we're looking beyond DOD.

I believe it is important that we confront waste throughout the Government. GAO has told us that the Department of Education, since its original testimony in April, has made significant progress in correcting the management failures in the purchase card program. HUD, however, continues to be more like the management at DOD.

I believe these issues are important because dollars wasted by the Government are dollars that are not available for the important programs within these agencies. However, even if we eliminate all of the purchase card problems at the Department of Education, there will not be enough money to fund Title I and Pell Grants and all the other important education programs. We are confronted with a more fundamental problem. There is simply not enough money to fund the Government next year. This problem exists not because of the events of September 11, but because of President Bush's tax cut. Given the title of this hearing, Disappearing Tax Dollars, it seems fitting that we look at this important information as well.

On the easel is a chart that summarizes a study by the Congressional Budget Office. CBO looked at the deterioration of the surplus since last year, and concluded that the main cause for the disappearing surplus is not September 11, and it is not the Bush recession. The main cause of the disappearing surplus is the Bush tax cut. The Bush tax cut has ended the brief period of surpluses and returned us to massive deficits.

The second chart shows just how dramatic the change is. If Congress does not restore the fiscal restraint that characterized the budget process during the Clinton administration, we face massive deficits over the next 10 years. As most economists will tell you, those deficits will have a chilling effect on the economy.

When President Clinton signaled to the world that he was serious about balancing the budget, it had an important effect. International investment began to flow into the U.S. economy and was one of the engines of the expansion of the 1990's. These deficits will have the opposite effect, holding back the economy and taking a toll on everyone. We have already seen that happening. Last week, the Department of Commerce announced that the poverty rate was up, and household income was down. The last time we saw poverty go up and income go down was during the recession in 1991. The tax dollars that disappeared because of the Bush tax cut are already having an effect on programs designed to help the neediest of our citizens, some of which are at the agencies before us today.

The failure of this administration to follow through on its commitment to education is shameful. The President's program, Leave No Child Behind, was supposed to provide our children with the resources needed to obtain the best education possible. Instead, the

President's education budget for 2003 would stop 6 years of steady progress and Federal support to local schools. The President's education budget would reduce Pell Grants, eliminate funding for rural education and technological training for teachers, resulting in 16,000 fewer teachers getting trained and 50,000 fewer children in after-school programs. It is clear that in the President's budget, children are being left behind.

This afternoon, Ms. Calbom from GAO will testify about the waste, fraud and abuse at the Department of Housing and Urban Development. Quite frankly, I'm not surprised. I am dismayed at the insensitivity of the leadership at HUD toward the people they are supposed to serve. Last year, I introduced the Domestic Violence and Sexual Assault Victims Housing Act, which had bipartisan support, it does have, and over 100 co-sponsors. One of the main provisions of that bill, funding for transitional housing for domestic violence victims, was included in the bill sponsored by Chairwoman Marge Roukema of the Housing and Community Opportunities Subcommittee. The Secretary of HUD opposes these provisions and argues that there are sufficient programs for these victims. Why then does the HUD Commission's evaluation of transitional housing programs find that among all people served battered women are the least likely to experience improved employment and stable housing?

If the Bush administration can turn its back on these victims, it is not surprising that it turns its back on the financial management responsibilities at the Department. If financial management is any indication of clear priorities, then I guess I shouldn't be surprised.

As the chairman knows, I feel strongly about waste in our Government, because it steals money from those programs that are already under-funded. As the President leads our Nation on a path toward war, financial management in his administration is actually a national security liability. I commend him on his leadership on these issues, and it has been a pleasure to work with him on the subcommittee. While this isn't the last hearing, I want to say, even in his absence, I want to salute the chairman of this subcommittee for his many accomplishments under his leadership.

Thank you. And I'm going to go vote, too. We'll be back soon.

The subcommittee is at recess. Thank you.

[The prepared statement of Hon. Janice D. Schakowsky follows:]

**STATEMENT OF THE HONORABLE JAN SCHAKOWSKY
AT THE HEARING ON
IMPROPER PAYMENTS**

October 3, 2002

Thank you Mr. Chairman for holding this hearing, and I thank the witnesses for taking time out of their busy schedules to testify today. I have worked with the chairman throughout this Congress to highlight the lack of fiscal management in the administration. Most of our work has focused on the Department of Defense, and it is clear that DOD is wasting public funds at an alarming rate.

I am pleased that today we are looking beyond DOD. I believe it is important that we confront waste throughout the government. GAO has told us that the Department of Education, since its original testimony in April, had made significant progress in correcting the management failures in the purchase card program. HUD, however, continues to behave more like the management at DOD.

I believe these issues are important because dollars wasted by the government are dollars that are not available for the important programs within these agencies. However, even if we eliminate all of the purchase card problems at the Department of Education, there will not be enough money to fund Title I, and Pell Grants, and all of the other important education programs.

Mr. Chairman, we are confronted with a more fundamental problem – there simply is not enough money to fund the government next year. This problem exists, not because of the events of September 11, but because of President Bush's tax cut.

Given the title of this hearing – "Disappearing Tax Dollars" -- it seems fitting that we look at this important information as well. On the easel is a chart that summarizes a study by the Congressional Budget Office. CBO looked at the deterioration of the surplus since last year, and concluded that the main cause for the disappearing surplus is not September 11, and it is not the Bush recession. The main cause of the disappearing surplus is the Bush tax cut.

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The Secretary of HUD opposes these provisions, and argues that there are sufficient programs for these victims. Why then does a HUD commissioned evaluation of transitional housing programs find that among all people served, battered women are the least likely to experience improved employment and stable housing?

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[Recess.]

Mr. HORN. We will need to have you take the oath, so if you would stand up and raise your right hands.

[Witnesses sworn.]

Mr. HORN. Thank you.

The clerk will note that all three witnesses affirmed. And we will now start from the witnesses in the order. You've been here many times, Linda, and we thank you, Linda Calbom, Director, Financial Management and Assurance, General Accounting Office.

STATEMENT OF LINDA CALBOM, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GENERAL ACCOUNTING OFFICE

Ms. CALBOM. Thank you, Mr. Chairman. I'm pleased to be here today to discuss the results of our improper payments reviews of selected areas of the Departments of Housing and Urban Development and Education, and also to talk about some strategies these and other Federal agencies can use to better management their improper payments.

Improper payments occur for many reasons, but the root causes can typically be traced to a breakdown in internal control. This certainly was the case at both HUD and Education for the areas we reviewed, which included purchase card transactions at both HUD and Education, grant and loan disbursements at Education and multi-family contractor payments at HUD. First, purchase cards. We found, as you were mentioning, Mr. Chairman, that both HUD and Education lacked fundamental internal controls over their purchase card program.

For example, neither agency had an effective review and approval process. While both had policies requiring supervisory review of monthly purchase card statements and supporting documentation, this process was not carried out effectively for 77 percent of our sampled transactions at HUD and 37 percent of our sampled transactions at Education. Combined with the lack of monitoring over these programs an environment was created at HUD and Education where improper purchases could be made with little risk of detection.

Inadequate controls over these expenditures, along with the inherent risk of fraud and abuse associated with purchase cards, likely contributed to the \$3 million of fraudulent, improper and questionable purchases we identified at HUD and Education. The bulk of these transactions, about \$2.3 million, relates to questionable purchases at HUD from vendors such as Lord and Taylor, Clean Cuts Music and the Cheesecake Factory, for which the agency could provide little or no supporting documentation.

We also identified over \$1 million of likely split purchases at HUD and Education. These are purchases that are split into two or more transactions in order to circumvent the \$2,500 micro purchase limit. Education has taken a number of actions to address our recommendations we made to them regarding the problems with purchase cards that we identified in our review. I'm sure that you'll hear about that in a few minutes. We will be making similar recommendations to HUD in a forthcoming report.

Controls were also an issue in Education's grant and loan disbursements, which did not include a key edit check or followup process to help identify schools that were disbursing Pell Grants to ineligible students. Our test and followup investigation identified four schools that fraudulently or improperly disbursed about \$3.4 million of Pell Grants to ineligible students. We referred the results of our investigation of these four schools to Education's Inspector General. We also identified 31 other schools that had similar disbursement patterns, and we have referred those to Education for followup.

Now I want to talk a little bit about some of the problems we found with contractor oversight at HUD. HUD contracts with two property management firms to oversee the operation of its multifamily properties, including arranging for repairs, maintenance and renovation. We found that one of these property management firms regularly circumvented HUD controls by alleging that construction renovations were emergencies, thus not requiring multiple bids or HUD pre-approval, and splitting renovations into multiple projects to stay below the \$50,000 threshold of HUD-required approval.

HUD failed to comply with its own policies that require quarterly onsite inspections and management reviews, and thus did not question these practices, which based on our review resulted in several cases where HUD paid for work that was not performed. In one such case, HUD's contractor submitted falsified documents indicating emergency replacement of 15,000 square feet of sidewalk at a cost of \$227,500. The work was billed on five identical invoices for \$45,500 each, for replacement of concrete sidewalk in front of five buildings.

With the assistance of an independent construction firm, we determined that only about one-third of the work billed and paid for was actually performed. As an example, we brought a photograph today, which I think is in your packet there, Mr. Chairman, that shows the front of one of the buildings; the outlined portion is the portion of the sidewalk that was actually replaced. The other portion that's not outlined was billed for but had not been replaced.

As a result of this, for the work done at the five buildings, more than \$164,000 of the \$227,500 billed and paid for emergency installation of concrete sidewalk appears to be fraudulent. The HUD OIG and GAO Offices of Special Investigations are now investigating this case, as well as other improprieties we found during our review of this contractor.

Mr. HORN. That insert will be in the record at this point, and it's HUD Improper Payments, \$164,000 overpayment for sidewalk repairs.

Ms. CALBOM. Yes, thank you, Mr. Chairman. By the way, that picture is also on page 17 of my written statement.

I'd like to shift gears just a little bit now and talk about some of the things that HUD, Education and other Federal agencies can do to comprehensively address their improper payments. Our executive guide, which is entitled Strategies to Manage Improper Payments, Learning from Public and Private Organizations, which was issued last October, identifies strategies that other organizations, both here and abroad, found effective in reducing improper payments. And it provides some case illustrations and other informa-

tion for Federal agencies to consider when addressing improper payments.

Again, we have another insert, Mr. Chairman, that I think is in your packet, and we also have a chart here that really shows the five key areas of internal controls which can be used to combat improper payments. As is shown in this chart, it's a circular process, and that indicates that it really is a continuous process that's inter-related.

The first area, which is the perimeter, is the control environment. This really deals with instilling a culture of accountability. Setting the tone at the top is critical in this area and must include clearly communicating from the top the need for improved program operations and changes in organizational culture. As the chart shows, this area surrounds and reinforces all of the other control areas.

The next area is risk assessment. This is determining the nature and extent of the problem. It's very easy to rationalize avoiding addressing a problem if you don't know how big it is. And it's just critical that the problem be identified and measured through a systematic risk assessment process and openly communicated to all relevant parties. Mr. Chairman, this is exactly what your bill calls for. It's absolutely key to this whole process.

Control activities are the next area. And that's taking action to address identified risks. Organizations need to tailor their activities to fit their particular needs. There's a wide range of activities, both high tech and low tech, that can be efficiently and effectively used to address improper payments. Information and communication is the next area. That's using and sharing knowledge to manage improper payments. An important part of this strategy involves the education of agency employees, contractors and beneficiaries about what is expected of them and the consequences of not meeting those expectations.

Finally, monitoring is tracking the success of improvement initiatives. Just putting control activities in place is not the end of the process. Monitoring progress and results is essential and must include the involvement of top officials.

In closing, Mr. Chairman, I want to emphasize that high levels of improper payments need not and should not be an accepted part of running Federal programs. And I know that you agree with that.

The organizations in our study found that they could effectively and efficiently manage improper payments, using the strategies I just outlined that are discussed in detail in our executive guide. While HUD, Education and other agencies have taken some steps in these areas, effectively addressing improper payments requires a comprehensive strategy that permeates the entire organization. Implementation of this process in the Federal Government will not be easy or quick, and it will take money. However, as shown in our study, such investments ultimately pay for themselves in program savings, and also produce large dividends in the form of renewed public trust and confidence.

That concludes my statement, Mr. Chairman.

[The prepared statement of Ms. Calbom follows:]



United States General Accounting Office

Testimony

Before the Subcommittee on Government Efficiency,
Financial Management and Intergovernmental Relations,
House of Representatives

For Release on Delivery
Expected at 2:00 p.m.
Thursday, October 3, 2002

FINANCIAL MANAGEMENT

Strategies to Address Improper Payments at HUD, Education, and Other Federal Agencies

Statement of Linda Calbom
Director, Financial Management and Assurance



GAO-03-167T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss (1) how internal control weaknesses we have noted make the departments of Housing and Urban Development (HUD) and Education vulnerable to, and in some cases have resulted in, improper and questionable payments and (2) strategies these and other federal agencies can use to better manage their improper payments. We are reporting our findings on HUD for the first time today. We previously reported our Education findings in a number of reports and testimonies.¹ In addition, we issued an executive guide, *Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations*,² last October, which we will also focus on in this testimony.

The federal government of the United States – the largest and most complex organization in the world – expends approximately \$2 trillion a year. As the steward of taxpayer dollars, it is accountable for how its agencies and grantees spend those funds, and is responsible for safeguarding against improper payments by the government—payments that should not have been made or that were made for incorrect or excessive amounts.

Improper payments are a widespread and significant problem receiving increased attention not only in the federal government but also among states, foreign governments, and private sector companies. As you know, the *President's Management Agenda, Fiscal Year 2002*, included five governmentwide initiatives, one of which is improved financial performance. This financial management initiative calls for the administration to establish a baseline on the extent of erroneous payments.³ Under it, agencies were to include information on improper payment rates in their 2003 budget submissions to the Office of Management and Budget (OMB), including actual and target rates if available for benefit and assistance programs over \$2 billion annually. Legislation that you sponsored, Mr. Chairman, and which is currently being considered by the Senate (H.R. 4878), calls for more stringent requirements in the areas of improper payment review and reporting than the *President's Management Agenda*. Specifically, it requires agency heads to (1) review all programs and activities that they administer, and identify those areas that may be susceptible to improper

¹U.S. General Accounting Office, *Financial Management: Internal Control Weaknesses Leave Department of Education Vulnerable to Improper Payments*, GAO-01-585T (Washington, D.C.: Apr 3, 2001); *Financial Management: Poor Internal Control Exposes Department of Education to Improper Payments*, GAO-01-997T (Washington, D.C.: July 24, 2001); and *Education Financial Management: Weak Internal Controls Led to Instances of Fraud and Other Improper Payments*, GAO-02-406, (Washington, D.C.: Mar 28, 2002).

²U.S. General Accounting Office, *Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations*, GAO-02-66G (Washington, D.C.: October 2001).

³Because of the similarity of the Office of Management and Budget's definition of erroneous payments to our definition of improper payments, we consider the terms synonymous.

payments, (2) estimate the annual amount of improper payments, and (3) where they exceed the lesser of 1 percent of the total program budget or \$1 million annually, report actions the agency is taking to reduce improper payments.

In our executive guide, we identified practices that government and private sector organizations in the United States, and abroad have used to combat improper payments. Despite a climate of increased scrutiny, most improper payments associated with federal programs continue to go unidentified as they drain taxpayer resources away from the missions and goals of our government. They occur for many reasons, including insufficient oversight or monitoring, inadequate eligibility control, and automated system deficiencies. However, one point is clear based on our study—the root causes of improper payments can typically be traced to a breakdown in or lack of internal control. Collectively, internal controls are an integral component of an organization's management that provides reasonable assurance that the organization achieves the objectives of (1) effective and efficient operations, (2) reliable financial reporting, and (3) compliance with laws and regulations. Internal controls are not one event, but a series of activities that occur throughout an entity's operations and on an ongoing basis. People make internal controls work, and responsibility for good internal controls rests with all managers.

Both HUD and Education have histories of financial management problems, including serious internal control weaknesses, which have affected their ability to provide reliable financial information to decision makers both inside and outside the agencies and to maintain the financial integrity of their operations. Because of this, we have designated Education's student financial assistance programs and HUD's single family and multifamily housing programs as high-risk areas for waste, fraud, abuse, and mismanagement.⁴ We have also identified weak internal controls as a major factor contributing to improper payments at other agencies and have issued reports and testimonies on this topic, including several to this subcommittee on the Department of Defense's purchase card and travel card programs.⁵

⁴U.S. General Accounting Office, *Major Management Challenges and Program Risks, Department of Housing and Urban Development*, GAO-01-248 (Washington, D.C.: January 2001); *Major Management Challenges and Program Risks, Department of Education* GAO-01-245 (Washington, D.C.: January 2001); and *High-Risk Series: An Update*, GAO-01-263, (Washington, D.C.: January 2001).

⁵U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-01-996T (Washington, D.C.: July 30, 2001); *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-32 (Washington, D.C.: Nov 30, 2001); *Purchase Cards: Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-506T (Washington, D.C.: Mar 13, 2002); and *Government Purchase Cards: Control Weaknesses Expose Agencies to Fraud and Abuse*, GAO-02-676T (Washington, D.C.: May 1, 2002).

In order to carry out our improper payments reviews at HUD and Education, we identified disbursement processes at those agencies that would be highly susceptible to improper payments.⁶ Based on this analysis, we focused our reviews on (1) HUD's purchase card and multifamily property payment processes and (2) Education's grants and loans, purchase card, and third party draft payment processes.⁷ Our work at both of these agencies was designed to (1) determine if the existing controls provided reasonable assurance that improper payments would not occur or would be detected in the normal course of business and (2) determine if expenditures were properly supported as a valid use of government funds. Our work at Education was also designed to determine if computer equipment purchased with purchase cards and third party drafts was being included in Education's inventory and appropriately safeguarded.

Our work at Education is complete, but our HUD work is ongoing. In the second phase of that work, we will continue to review multifamily disbursements and will also assess single family program payments to management and marketing contractors that maintain and sell single family houses owned by HUD. We will also follow up on physical control of computer equipment as we did at Education.

To accomplish our two separate reviews of HUD and Education, we used data mining techniques⁸ and other computer analyses to identify unusual transactions and payment patterns that may be indicative of improper payments. Our review included the \$181.4 billion in grants and loans disbursed by Education from May 1998 through September 2000, \$214 million of payments made by HUD during fiscal year 2001 for goods and services to support multifamily properties, \$22 million of purchase cards purchases made by Education from May 1998 through September 2000, and \$10 million of purchase cards purchases made by HUD during fiscal year 2001.⁹ We conducted our work in accordance with generally accepted government auditing standards, as well with investigative standards established by the President's Council on Integrity and Efficiency.

⁶We did not focus on HUD's rental housing assistance program because HUD is estimating improper payments for the program, and the HUD OIG and GAO have performed extensive work in that area.

⁷Our testimony today generally will not address third party drafts, since Education eliminated that payment process in fiscal year 2001. However, we will discuss the results of our inventory of computers and computer equipment purchased with third party drafts.

⁸Data mining for improper payments involves using computer-aided auditing techniques to identify hidden patterns and relationships in data that are indicators of unusual transactions, which may be improper payments.

⁹Due to separate congressional requests, the period of our review at Education differed from that for HUD.

Poor Controls over Purchase Cards Resulted in Some Fraudulent, Improper, and Questionable Purchases at HUD and Education

In my testimony today I will discuss

- poor controls over purchase cards and how they resulted in some fraudulent, improper, and questionable purchases at HUD and Education;
- the failure of controls over Education's grants disbursement process to detect certain improper payments;
- the lack of monitoring of a key HUD contractor and how it resulted in improper payments; and
- strategies that HUD, Education, and other federal agencies can use to manage improper payments.

The benefits of using purchase cards versus traditional contracting and payment processes are lower transaction processing costs and less "red tape" for both the government and the vendor community. We support the use of a well-controlled purchase card program to streamline the government's acquisition processes. However, it is important that agencies have adequate internal controls in place to protect the government from fraud, waste, and abuse. We found that both HUD and Education lacked fundamental internal controls over their purchase card programs that would have minimized the risk of improper purchases. For example, both agencies had inconsistent and inadequate pre-approval and review processes for purchase card transactions – key preventive and detective controls.

Combined with a lack of monitoring, environments were created at HUD and Education where improper purchases could be made with little risk of detection. Inadequate controls over these expenditures, along with the inherent risk of fraud and abuse associated with purchase cards, likely contributed to the \$3.0 million of fraudulent, improper, and questionable purchases we identified at HUD and Education through our data mining efforts.

According to our *Standards for Internal Control in the Federal Government*,¹⁰ transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. Although pre-approval and review of transactions by persons in authority is the principal means of assuring that transactions are valid, we found that the pre-approval and review process for purchase card purchases was inadequate at both HUD and Education.

During our review of HUD and Education's purchase card programs, we found that department personnel did not consistently obtain pre-approval prior to making some or all purchases, as required by the departments' policies. According to

¹⁰ *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1), which was prepared to fulfill our statutory requirement the Federal Managers' Financial Integrity Act, provides an overall framework for establishing and maintaining internal control and for identifying and addressing major management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

HUD's October 30, 1995, purchase card policy, the approving official is required to establish a pre-approval process for each cardholder to ensure that purchases have the necessary technical approval or clearance before purchases are made and that all transactions are appropriate and for official use only. However, during our review we found that only the Information Technology Office routinely obtained authorization prior to purchasing items with the purchase card. Similarly, at the Department of Education, we found that 10 of its 14 offices did not require cardholders to obtain authorization prior to making some or all purchases, although Education's policy required that all requests to purchase items over \$1,000 be made in writing to the applicable department executive officer.

One of the most important internal controls in the purchase card process is the review of supporting documentation and approval of each purchase by the approving official. Approving officials at both HUD and Education are required to review each monthly statement of purchases along with the applicable supporting documentation and certify that these purchases were appropriate, in accordance with department regulations, and a valid use of government funds. Based on our testing of both HUD and Education's approving officials' review of monthly purchase card statements, we found that this key control was not an effective means of detecting improper purchases. At HUD, we selected a stratified random sample of 222 purchase card transactions made during fiscal year 2001, and found that \$1.4 million, or about 77 percent, of the \$1.8 million of sampled purchases lacked adequate support for the approving official to determine what was purchased, whether the purchase was previously authorized, and if there was a legitimate government need for the items purchased.¹¹ We found similar problems at Education. To test the effectiveness of Education's approving officials' review, we analyzed 5 months of cardholder statements and found that 37 percent of the 903 monthly cardholder statements we reviewed were not approved by the appropriate official. These 338 unapproved statements totaled about \$1.8 million.

Another control that is effective in helping to prevent improper purchases is the blocking of certain merchant category codes (MCC). This control, available as part of the agencies' purchase card contracts with the card issuing financial institutions, allows agencies to prohibit certain types of purchases that are clearly not business related, such as purchases from jewelry stores or entertainment establishments. During our reviews, we noted that, initially, neither HUD nor Education was effectively using the MCC's as a preventive control. HUD was not blocking any MCCs and Education blocked only four MCCs. As a result, there were almost no restrictions on the types of purchases employees could make

¹¹Based on our testing, we estimate that \$4,678,689 (plus or minus \$678,806) of the total \$10 million in purchase card transactions made during fiscal year 2001 lacked adequate supporting documentation. Our estimate is based on a 95 percent confidence level and a tolerable error rate of \$1,059,046 (10 percent of the population total of \$10,590,461).

during the period of our audit. Both agencies took action to block more of the MCCs after we began our reviews of their purchase card programs.

Our *Standards for Internal Control in the Federal Government* state that internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. Internal control monitoring should assess the quality of performance over time and ensure that findings of audits and other reviews are promptly resolved. Program and operational managers should monitor the effectiveness of control activities as part of their regular duties. HUD's purchase card policy requires the department to perform annual program reviews and report the results, including findings and recommendations, to the purchase card program administrator. However, HUD officials could locate only one such report. This November 2001 report, prepared by a consultant, identified problems that were similar to the findings previously reported¹² by the Office of Inspector General (OIG) in February 1999. Both reports documented problems with weak internal controls and insufficient supporting documentation. The consultant's report also noted that HUD was not performing the periodic program reviews required by its policies and that employees were making improper split purchases. HUD management agreed with the findings in the OIG report and developed and implemented an action plan to address the identified weaknesses. According to HUD OIG staff, its recommendations were implemented and have been closed. However, based on our findings, corrective actions taken at that time were not fully effective.

At the time of our review, Education did not have a monitoring system for purchase card activity to determine whether its staff was complying with key aspects of the purchase card program. We also found that approving officials at Education did not use monitoring reports that were available from its purchase card contractor to identify unusual or unauthorized purchases. However, as I will discuss later, the department subsequently issued new policies and procedures that, among other things, establish a quarterly quality review of a sample of purchase card transactions to ensure compliance with key aspects of the department's policy.

The types of internal control weaknesses that I have just described created environments where improper purchases could be made with little risk of detection and likely contributed to the \$3 million of fraudulent, improper, and questionable purchases we identified through our data mining efforts at both HUD and Education. We also found that property purchased with purchase cards was

¹²Department of Housing and Urban Development Office of Inspector General, *Commercial Credit Card Program*, 99-DP-166-0001 (Washington, D.C.: Feb 1, 1999).

not always recorded in Education's property records, which likely contributed to missing or stolen property. This could also be an issue at HUD based on our preliminary inquiries into its property management system.

I will now provide a few examples of how employees used their purchase cards to make fraudulent, improper, and questionable purchases. We considered fraudulent purchases to be those that were unauthorized and intended for personal use. Improper payments include errors, such as duplicate payments and miscalculations; payments for services not rendered; multiple payments to the same vendor for a single purchase to circumvent existing single purchase limits – known as split purchases; and payments resulting from fraud and abuse. We defined questionable transactions as those that, while authorized, were for items purchased at excessive costs, for questionable government need, or both, as well as transactions for which the departments could not provide adequate supporting documentation to enable us to determine whether the purchases were valid.

In May 2002, we provided HUD with 5,459 transactions, totaling about \$3.8 million in which the (1) payee appeared to be an unusual vendor to be engaging in commerce with the agency, (2) purchase was made on either a holiday or weekend, or (3) purchase appeared to be a split purchase. As of September 2002, HUD was able to provide adequate support for 3,428 of these questionable transactions, totaling about \$1.5 million. HUD could not provide adequate supporting documentation to enable us to assess the propriety of the remaining 2,031 transactions totaling about \$2.3 million, or 38 percent of the total questionable transactions and 61 percent of the total dollars requested. For these transactions, HUD could not provide support to determine what was purchased, whether it was authorized, and whether there was a legitimate government need for the item purchased. These purchases included (1) 1,183 questionable vendor transactions totaling about \$869,000, (2) 31 purchases made on holidays totaling about \$10,000, (3) 264 weekend purchases totaling about \$354,000; and (4) 541 potential improper split transactions totaling about \$1 million.

Some examples of questionable vendor transactions for which we did not receive adequate support included (1) over \$27,000 to various department stores, such as Best Buy, Circuit City, Dillard's, JC Penny, Lord & Taylor, Macys, and Sears, (2) over \$8,900 to several music and audio stores, including Sound Craft Systems, J&R's Music Store, Guitar Source, and Clean Cuts Music, and (3) over \$9,700 to various restaurants, such as Legal Sea Foods, Levis Restaurant, The Cheesecake Factory, and TGI Fridays. Additional examples of questionable or improper purchases we found included \$25,400 of "no show" hotel charges for HUD employees who did not attend scheduled training and \$21,400 of purchases from vendors where it appears the vendors were out of business prior to the purchases. Because HUD was unable to provide adequate documentation for these purchases,

we consider them to be questionable uses of government funds and therefore potentially improper purchases.

In order to identify potential improper payments in Education's purchase card program, we requested supporting documentation for (1) 338 monthly statements totaling \$1.8 million that our testing of the approval function identified as not properly approved, and (2) other transactions, identified using data mining techniques, that appeared unusual. Education was unable to provide adequate supporting documentation to enable us to determine the validity of purchases totaling over \$218,000.

Education could not provide any support for more than \$152,000 of these purchases nor could it specify what was purchased, why it was purchased, or whether these purchases were appropriate. For the remaining \$66,000, Education was able to provide only limited supporting documentation. As a result, we were unable to assess the validity of these payments, and we consider these purchases to be potentially improper. These inadequately supported or unsupported purchases included charges to various hotels for more than \$3,000, purchases of computer equipment and software totaling more than \$22,000, and charges for various college and other training courses totaling about \$51,000. Numerous other purchases were made from home electronics and appliance stores as well as toy, book, and furniture stores.

In our review of the documentation Education did provide, we identified some fraudulent, improper, and questionable purchases. Examples of these include the following:

- In one instance, a cardholder made several fraudulent purchases from two Internet sites for pornographic services. As a result, Education management issued a termination letter, prompting the employee to resign.
- Over several years, an Education employee made improper charges totaling \$11,700 for herself and a coworker to attend college classes that were unrelated to Education's mission, such as biology, music, and theology.¹³ This same individual also had numerous questionable charges for other college classes totaling \$24,060.
- There were restaurant charges totaling \$4,427 from a Year 2000 focus group meeting in San Juan, Puerto Rico, for meals for nonfederal employees. We referred additional charges of this same nature totaling approximately \$45,000 to Education's OIG.¹⁴

¹³The Government Employees Training Act, 5 U.S.C. 4103 and 4107, requires that training be related to an employee's job and prohibits expenditures to obtain a college degree unless necessitated by retention or recruitment needs, which was not the case here.

¹⁴These additional estimated charges were identified by an Education official. Under 31 U.S.C. 1345, appropriated funds may not be used to pay the costs of non-federal individuals to attend meetings

Another type of improper purchase we identified is the “split purchase,” which we defined as purchases made on the same day from the same vendor that appear to circumvent single purchase limits. *Federal Acquisition Regulation* prohibits splitting a transaction into more than one segment to avoid the requirement to obtain competitive bids for purchases over the \$2,500 micro-purchase limit. At HUD, we identified 88 improper purchases totaling about \$112,000 where employees made multiple purchases from a single vendor on the same day in excess of the \$2,500 micro-purchase threshold. For example, one cardholder purchased nine personal digital assistants and the related accessories from a single vendor on the same day in two separate transactions just 5 minutes apart. Because the total purchase price of \$3,788 exceeded the cardholder’s single purchase limit of \$2,500, the purchase was split into two transactions of \$2,388 and \$1,400, respectively. We identified 451 additional purchases totaling \$893,000 where HUD employees made multiple purchases from a vendor on the same day in excess of \$2,500. Although we were unable to determine whether these purchases were improper, based on the available supporting documentation, these transactions share similar characteristics with the 88 split purchases we identified.

We also found improper split purchases at Education. For example, one cardholder from Education purchased two computers from the same vendor at essentially the same time. Because the total cost of these computers exceeded the cardholder’s \$2,500 single purchase limit, the total of \$4,184.90 was split into two purchases of \$2,092.45 each. We found 27 additional purchases totaling almost \$120,000 where Education employees improperly made multiple purchases from a vendor on the same day.

In addition to poor internal controls over the purchase card program, we found that Education lacked appropriate physical controls and segregation of duties over computer equipment purchased with purchase cards and third party drafts. According to the Education Inspector General, the department had not taken a comprehensive physical inventory for at least 2 years before our review. Further, one office lacked appropriate segregation of duties where responsibility for receiving, bar coding, securing the equipment, and delivering computers to the end users was done by only two individuals. According to our *Standards for Internal Control in the Federal Government*, an agency must establish physical control to secure and safeguard vulnerable assets. Such assets should be periodically counted and compared to control records. Recording the items purchased in property records is an important step to ensuring accountability and financial control over these assets and, along with periodic inventory counts, to preventing theft or improper use of government property.

unless otherwise specifically authorized by law. 5 U.S.C. 5703 allows the federal government to pay the costs of non-federal individuals to attend meetings if the attendees are providing direct services to the government. Education could not provide us with evidence that this was the case.

At Education, we found that employees regularly purchased computers using their purchase cards, which was a violation of the department's policy prohibiting the use of purchase cards for this purpose. From May 1998 through September 2000, the period covered by our audit, Education made purchases totaling more than \$2.9 million from personal computer and computer-related equipment vendors. To determine whether this computer equipment was appropriately recorded in the department's inventory, we compared serial numbers obtained from the department's largest computer vendor to those in the asset management system and identified 384 pieces of computer equipment, including desktop computers, printers, and scanners, that were not in the property records. We conducted an unannounced inventory to determine whether the equipment was actually missing or inadvertently omitted from the property records. Although we found 143 pieces of equipment during this inventory that were not recorded on Education's books, and an additional 62 items were later found by Education, department officials have been unable to locate the remaining 179 pieces of missing equipment costing over \$200,000. They surmised that some of these items may have been surplus; however, there is no documentation to determine whether this assertion is valid.

According to Education officials, new policies were implemented that do not allow individual offices to purchase computer equipment without the consent of the Office of the Chief Information Officer. In addition, the new policies were designed to maintain control over the procurement of computers and related equipment, including

- purchasing computers from preferred vendors that apply the department's inventory bar code label and record the serial number of each computer on a computer disk that is sent directly to the Education official in charge of the property records;
- loading the computer disk containing the bar code, serial number, and description of the computer into the property records; and
- having an employee verify that the computers received from the vendor match the serial numbers and bar codes on the shipping documents and the approved purchase orders.

While these are very positive steps, a continued lack of adequate physical control could negate the effectiveness of these new procedures. For example, during a follow-up visit to Education, we found that the doors to the various rooms used to store computer equipment waiting to be installed were both unlocked and unattended. Without enhanced physical security, Education will continue to be at risk for further computer equipment losses.

We also have concerns about HUD's accountability for computer and related equipment purchased with purchase cards because of the large volume of

purchases for which it did not have appropriate documentation. In these cases, HUD likely does not know what was purchased, why it was purchased, whether there was a legitimate government need for the item purchased, and where the item is now. For example, HUD employees used their purchase cards to purchase portable assets such as computer equipment and digital cameras, totaling over \$74,500, for which they have provided either no support or inadequate support. Further, in its purchase card remedial action plan, which I will discuss further shortly, HUD stated that not all property is entered in its automated property inventory system. When these purchases are not entered in an agency's inventory system, they become more vulnerable to loss or theft. In our follow-up work, we plan to determine whether these items are included in HUD's inventory and are being appropriately safeguarded.

Effectiveness of Remedial Action Plans and Other Recent Steps to Curb Purchase Card Abuse Is Mixed

In April 2002, OMB issued a memorandum requiring all agencies to develop remedial action plans to manage the risk associated with purchase card usage. Agencies were required to submit their plans to the Office of Federal Procurement Policy no later than June 1, 2002. Both HUD and Education submitted their plans to OMB on time. While Education's plan was accepted by OMB and addressed the findings and recommendations in our September 2001 interim report and final Education report, HUD's plan was rejected because it lacked a timeline for when the corrective actions would be implemented. This plan also did not address key weaknesses we identified.

HUD submitted a new plan to OMB on August 28, 2002. While the revised remedial action plan includes a broad timeline for when each objective will be completed, we found that it still does not adequately address key control weaknesses we identified, in part because it lacks specific steps necessary to fully address identified problem areas. For example, HUD's plan recognizes that monitoring of purchasing activities and the frequency of internal audits are areas that need improvement. However, the plan does not address developing and implementing a robust review and approval function for purchase card transactions, focusing on identifying split purchases and other inappropriate transactions. Further, this plan does not timely address some of the other serious weaknesses we found. For example, the revised remedial plan does not require the program administration staff to begin designing a monitoring plan to assess HUD's compliance with key aspects of its purchase card policy until the second quarter of fiscal year 2003 and does not give an estimated completion date for when this key internal control will be implemented. Additionally, the revised plan does not specifically identify who is responsible for developing or implementing any of the proposed improvements. We will be issuing a separate letter to HUD that will include recommendations to address these and other issues we identified during our review of its purchase card program.

In contrast, Education's plan specifically addresses the findings and recommendations in our September 2001 interim report and final Education reports. These recommendations included (1) emphasizing policies on appropriate use of the purchase card and cardholder and approving official responsibilities, (2) ensuring that approving officials are trained on how to perform their responsibilities, and (3) ensuring that approving officials review purchases and their supporting documentation before certifying the statements for payment. Education took actions to respond to these recommendations, such as (1) reducing monthly and single purchase spending limits, (2) blocking over 300 MCCs, (3) implementing a new approval process, and (4) issuing new policies and procedures.

However, during our follow-up work at Education, we found that weaknesses remained that continued to leave the department vulnerable to fraudulent and improper payments and lost assets. For example, the effectiveness of the department's new approval process was minimized because approving officials were not ensuring that adequate supporting documentation existed for all purchases. According to Education, it has since implemented a quarterly monitoring program to assess compliance with key aspects of the purchase card program. As discussed in our Executive Guide, which I will cover later, managing improper payments is a continuous cycle and includes, among other things, constant monitoring of the effectiveness of implemented controls and adjustments to these controls as warranted by monitoring results.

Controls over Education's Grants Disbursement Process Failed to Detect Certain Improper Payments

Education's grant and loan disbursement process relies on computer systems application controls, or edit checks, to help ensure the propriety of payments. We focused our review on these edit checks and related controls because they are key to helping prevent or detect improper payments in an automated process. As we testified in July 2001,¹⁵ controls over grant and loan disbursements at Education did not include a key edit check or follow-up process that would help identify schools that were disbursing Pell Grants to ineligible students. To identify improper payments that may have resulted from the absence of these controls, we performed a variety of tests, including a test to identify students 70 years of age and older because we did not expect large numbers of older students to be receiving Pell Grants.¹⁶ Our review also built upon earlier work where we identified abuses in the Pell Grant program.¹⁷ Based on the initial results of our tests and because of the problems we identified in the past, we expanded our review of seven schools that had disproportionately high numbers of older

¹⁵U.S. General Accounting Office, *Financial Management: Poor Internal Control Exposes Department of Education to Improper Payments*, GAO-01-997T (Washington, D. C.: July 24, 2001).

¹⁶A Pell Grant is a form of financial aid that is awarded to undergraduate students who have not earned bachelor's or professional degrees, and who are enrolled in degree or certificate programs.

¹⁷U.S. General Accounting Office, *Student Financial Aid Programs: Pell Grant Program Abuse*, GAO/T-OSI-94-8 (Washington, D.C.: Oct 27, 1993).

students to include recipients 50 years of age and older. We found that three schools fraudulently disbursed about \$2 million in Pell Grants to ineligible students, and another school improperly disbursed about \$1.4 million in Pell Grants to ineligible students. We also identified 31 other schools that had similar disbursement patterns to those making the payments to ineligible students. These 31 schools disbursed approximately \$1.6 million of Pell Grants to potentially ineligible students. We provided information on these schools to Education for follow-up.

Education's staff and officials told us that they have performed ad hoc reviews in the past to identify schools that disbursed Pell Grants to ineligible students and have recovered some improper payments as a result. However, Education did not have a formal, systematic process in place specifically designed to identify schools that may be improperly disbursing Pell Grants. In our September 2001 interim report, we recommended that the Secretary of Education (1) establish appropriate edit checks to identify unusual grant and loan disbursement patterns and (2) design and implement a formal, routine process to investigate unusual disbursement patterns identified by the edit checks.

Education subsequently implemented an age limit edit check of 75 years of age or older. If the student's date of birth indicates that he or she is 75 years of age or older, the system edit will reject the application and the school will not be authorized to give the student federal education funds until the student either submits a corrected date of birth or verifies that it is correct. However, without also looking for unusual patterns and following up, the edit may not be very effective, other than to correct data entry errors or confirm older students applying for aid.

Education also implemented a new system, called the Common Origination and Disbursement (COD) system, which became operational in April 2002. Education officials told us that this integrated system will replace the separate systems Education has used for Pell Grants, direct loans, and other systems containing information on student aid, and it will integrate with applicant data in the application processing system. The focus of COD is to improve program and data integrity. If properly implemented, a byproduct of this new system should be improved controls over grant and loan disbursements. According to Education officials, they will be able to use COD to identify schools with characteristics like those we identified. However, until there is a mechanism in place to investigate schools once unusual patterns are identified, Education will continue to be vulnerable to the types of improper Pell Grant payments we identified during our review.

We performed several additional tests of Education's disbursements to identify potentially improper grant and loan payments that may not have been detected because of missing or ineffective edit checks. In addition to Pell Grant payments to students 70 years of age and older, we identified \$28.8 million of other potentially improper grant and loan payments made by more than 1,800 schools to students who (1) were much older or younger than would be expected, (2) had social security numbers (SSN) that were either not in Social Security Administration (SSA) database or were in SSA death records, or (3) received Pell Grants in excess of statutory limits. Based on supporting documentation provided to us by Education, we determined that \$20.3 million of these payments were proper. However, Education did not provide adequate supporting documentation to enable us to determine the validity of the remaining \$8.5 million of payments made by these schools. Although Education officials told us that they requested supporting documentation from the approximately 1,800 schools that disbursed these funds, over 1,000 schools did not provide the documentation, and documentation provided by some of the schools was inadequate for independent verification of the validity of these payments.

According to Education officials, if a school that did not provide support or provided inadequate support had only a small number of potential improper payments, the department did not follow up because it did not consider doing so a wise use of its resources. We agree that Education should weigh the costs of resources required to follow up on potential improper payments with the benefits that could be obtained when making such decisions. However, 20 of the schools that did not provide support or provided inadequate support had from 20 to 138 instances of these potential improper payments totaling \$1.5 million.

While the amount of improper and potentially improper grant and loan payments we identified is relatively insignificant compared to the billions of dollars disbursed for these programs annually, it represents a control risk that could easily be exploited to a greater extent. As I will discuss later, once such a risk has been identified, appropriate control activities need to be implemented to respond to it.

In addition to the recommendations that I have already discussed, we previously recommended that Education (1) conduct on-site investigations, including interviews of school personnel and students, at the 28 schools with characteristics similar to those we found that improperly disbursed Pell Grants to determine whether the grants were properly disbursed, (2) follow up with the schools that had high concentrations of the \$12 million in potential improper payments for which the department did not provide adequate supporting documentation, and (3) implement a process to verify borrowers' SSNs and dates of birth submitted by schools to Loan Origination System (LOS). While Education has implemented a

process to verify borrowers' SSNs and dates of birth submitted by schools to LOS, the other two recommendations remain open.

Lack of Monitoring of a Key HUD Contractor Resulted in Improper Payments

Internal control standards state that monitoring should assess the quality of performance over time and ensure that review findings are promptly resolved. Due to a lack of monitoring, the internal controls of the HUD multifamily housing program's payment processes do not provide reasonable assurance that improper payments would be identified and corrected in the normal course of business. As we testified in July 2002, HUD has a limited ability to effectively monitor its contractors and as I am about to discuss, this left HUD vulnerable to abusive billing practices by its property management firms.¹⁸

HUD contracts with two property management firms, which are given a great deal of autonomy, to manage the operation of its multifamily properties,¹⁹ including apartment projects, nursing homes, and hospitals. These management firms are charged with initiating property renovations, hiring on-site staff, selecting vendors and certifying the acceptable delivery and performance of these activities. The vendors that provide the goods and services at the HUD properties submit their invoices to the property management firm for payment by HUD. The management firm forwards the invoices and required supporting documentation to another HUD contractor that maintains the department's property management system, provides a limited cursory review of the supporting documentation, and pays the vendors. HUD pre-approval for payment of these goods and services is not required when (1) the vendor's estimate will cost less than agreed upon dollar thresholds, which, depending upon the property management company, are as high as \$50,000, or (2) an emergency situation exists that affects or endangers the health and/or safety of residents or property. The property manager is also not required to obtain competitive bids when the work is done to correct an emergency situation. Generally, the contractor that pays the vendors obtains a daily E-mail authorization from HUD prior to disbursing the funds. However, unless the amount exceeds the predetermined thresholds, HUD does not routinely review documentation supporting the payments and does not verify that the work was actually performed.

Given the fairly broad delegation of authority to these contractors, it is important that HUD have effective processes for monitoring performance and the propriety of payment. We found that HUD did not comply with its monitoring policy to perform quarterly, on-site inspections and management reviews of its multifamily housing projects and had incomplete guidance on how to do so. Inspections and

¹⁸U.S. General Accounting Office, *HUD Management: HUD's High-Risk Program Areas and Management Challenges*, GAO-02-868T (Washington, D.C.: July 24, 2002).

¹⁹In addition, HUD and the Massachusetts Housing Finance Agency have an agreement for the disposition and interim management of select HUD-owned multifamily properties in Boston. This pilot project was not implemented for other state housing agencies.

reviews were not conducted at the majority of multifamily properties and HUD could not provide documentation for some of the limited reviews and inspections that HUD officials said were performed. We found no on-site inspection guidance in the multifamily handbook, which establishes the policies and procedures to be followed by the multifamily staff.

In two instances where HUD did conduct and document reviews of one of the property management firms, it did not follow up on or promptly resolve its findings. Based on these two reviews of the purchasing practices of the property management firm, HUD documented concerns about the (1) amount of money being disbursed to a limited number of construction companies with little control in place to ensure fair and reasonable prices and (2) unusually high number of emergency renovations made by this management firm. Yet HUD continued to authorize payments of over \$8 million to these construction companies after it was known that the property management firm was not selecting these companies in accordance with provisions of its contract that required obtaining competitive quotes from several vendors for purchases below the \$50,000 pre-approval threshold. Obtaining competitive quotes helps ensure that the government pays a reasonable price for goods and services.

The property management firm told HUD that the vendors it used were the only ones that would work in the neighborhoods where the properties were located, and that other vendors did not feel comfortable with HUD's vendor payment process. HUD's staff accepted this explanation without independent verification. Had HUD followed up on their findings, it may have discovered what we found – funds being disbursed for alleged emergency goods and services that were not received or performed.

Using computerized data mining techniques, we analyzed the \$214 million of multifamily property payments made during fiscal year 2001 to identify potentially improper payments that could have resulted from HUD's lack of contractor oversight. The majority of the questionable disbursements identified by our analyses were for transactions initiated by one of the two management firms. Hence, we concentrated our efforts on HUD disbursements for this firm's transactions. Based on our data mining and reviews of the supporting documentation, we determined that a vice president and maintenance director of this property management firm, on numerous occasions circumvented HUD controls by (1) alleging that construction renovations were emergencies, thus not requiring multiple bids or HUD pre-approval, and (2) splitting renovations into multiple projects to stay below the \$50,000 threshold of HUD-required approval. Over 18 months HUD authorized and paid for approximately \$10 million of renovations, of which each invoice was for less than \$50,000, at two properties where the above-mentioned maintenance director was employed. HUD did not

verify that any of the construction renovations were actually performed or determine whether the emergency expenditures constituted such a classification.

The following examples of improprieties, which are now being investigated by the HUD OIG and our Office of Special Investigations, could have been prevented or detected had HUD performed its contractor monitoring responsibilities. During June 2001, the maintenance director of the property management company falsified documents that indicated that 15,000 square feet of concrete sidewalk, at a cost of \$227,500, was replaced and classified these repairs as an emergency. To remain below the HUD threshold of \$50,000, the property management maintenance director had the vendor submit five separate invoices, each for \$45,500, for the replacement of 3,000 square feet of concrete sidewalk in front of five buildings. HUD's contractor paid all five invoices. Based on our site visits and conversation with the maintenance director, we determined the square footage billed for sidewalk replacement had not actually been replaced. Figure 1 illustrates how only portions (the lighter shaded sections) of the sidewalk were replaced and not the entire sidewalk as was listed on the paid invoices.

Figure 1: HUD Improper Payments



With the assistance of an independent construction firm, we hired, we determined that only about one-third of the work HUD paid for was actually performed. As a result, more than \$164,000 of the \$227,500 billed and paid for "emergency" installation of concrete sidewalk appears to be fraudulent.

At this same property, we found instances where HUD paid construction companies for certain apartment renovations, deemed "emergency repairs," that were not made. Three of the 10 tenants we interviewed told us that some work

listed on the invoice that the property management firm submitted was not performed at their homes. For instance, while an invoice indicated that the apartment floor and closet doors had been replaced at a cost of \$10,400, the tenant stated that the floors and doors were never replaced.

On several other occasions, HUD paid the same amount to perform “emergency renovations” of apartments of varying sizes and, more than likely, in differing degrees of disrepair. For example, HUD paid three identical \$32,100 invoices for the emergency renovation of a one bedroom (600square feet), a two bedroom (800 square feet) and a three bedroom (1000 square feet) apartment. All three invoices listed the exact work performed. For example, each invoice listed a \$4,500 cabinet fee, yet the one bedroom unit had five fewer cabinets than the three bedroom dwelling. We and the independent construction firm we hired questioned the validity of the same charge for units of varying sizes and the likelihood of numerous apartments being in identical condition and in need of the same extensive renovations.

When confronted with these disparities, the property management company’s maintenance director told us that although he did not have any documentation to support it, he kept mental notes of work that was billed and not performed and had the construction company perform additional unbilled renovations, rather than revising original emergency invoices. Our review of the maintenance director’s files found multiple “boilerplate” copies of signed receiving reports, indicating that acceptable emergency work had been done, that had yet to be awarded to vendors, further evidence of ongoing improprieties.

We will be providing formal recommendations to HUD to address these issues, as well as other acquisition management challenges, in a separate report to be issued in November 2002.

Strategies to Manage Improper Payments

Now I would like to talk about some of the things that HUD, Education, and other federal agencies can do to address their improper payments comprehensively. As we recently reported,²⁰ our review of improper payments reported in agency financial statements over the past 3 years shows some change in individual agencies and programs, but little change in the total amount over the period. While the total reported amount has decreased from about \$20.7 billion in fiscal year 1999 to \$19.1 billion in fiscal year 2001, these figures do not give a true picture of the level of improper payments in federal programs and activities. As significant as the \$19 billion in improper payments is, the actual extent of improper payments government wide is unknown, likely to be billions of dollars

²⁰U.S. General Accounting Office, Financial Management: *Coordinated Approach Needed to Address the Government’s Improper Payments Problems*, GAO-02-749 (Washington, D.C.: Aug 9, 2002)

more, and will likely grow without concerted, coordinated efforts by agencies, the administration, and the Congress.

As we have seen, weak or nonexistent internal controls can result in a variety of improper payments that can affect an agency's ability to achieve its goals. Attacking the problem of improper payments requires strategies tailored to the organization involved and its particular risks. To identify effective practices and provide case illustrations and other information for federal agencies to consider when addressing improper payments, we contacted public and private sector organizations and talked with them about actions they had taken and considered effective in reducing improper payments. Participants were the Department of Health and Human Services' Health Care Financing Administration;²¹ the Social Security Administration; the Department of Veterans Affairs; the states of Illinois, Texas, and Kentucky; the governments of Australia, New Zealand, and the United Kingdom; and three private sector corporations. Our executive guide, *Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations*, issued last year, highlights the actions taken by these organizations. We categorized the actions into the five components of internal control outlined in the Comptroller General's *Standards for Internal Control in the Federal Government*. We defined these components as follows:

- Control environment—creating a culture of accountability by establishing a positive and supportive attitude toward improvement and achievement of established program outcomes.
- Risk assessment—performing comprehensive reviews and analyses of program operations to determine if risks exist and if so, their nature and extent.
- Control activities—taking actions to address identified risk areas and help ensure that management's decisions and plans are carried out and program objectives are met.
- Information and communications—using and sharing relevant, reliable and timely financial and nonfinancial information in managing activities related to improper payments.
- Monitoring—tracking improvement initiatives over time, and identifying additional actions needed to further improve program efficiency and effectiveness.

I will address each of these control activities briefly in turn, giving examples that illustrate their use in combating improper payments. While I will discuss these activities separately, it is important to remember that managing improper payments typically requires continuous interaction among these areas.

²¹The Health Care Financing Administration was renamed the Centers for Medicare and Medicaid Services in July 2002.

Control Environment: Instilling a Culture of Accountability

Perhaps the most significant of the elements critical to identifying, developing and implementing activities to reduce improper payments is the control environment. Top officials, whether in government or the private sector, and oversight bodies such as legislatures, set the stage for change with clearly established expectations and demands for improvement. Many of the officials we met with in the course of our work told us that without the clearly established demands and expectations for improvement by top management and legislators, little would have happened to effectively reduce fraud and errors in their programs. In addition, while top management sets the tone for cultural change, all personnel must buy into this change and work to achieve its overall goals.

The cultural change fostered by an effective control environment stresses the importance of improvement and efficient and effective program operations while maintaining a balance with concerns about privacy and information security in a world where computers and electronic data are indispensable to making payments. In the oversight and legislative arena, it involves initiatives such as those in the *President's Management Agenda*, as I discussed earlier and legislation such as that introduced by you, Mr. Chairman, which requires comprehensive improper payment reviews and reporting.

Interest in the amount of improper payments at the organizations that participated in our study often resulted from program, audit or media reports of misspent funds or fraudulent activities. As the magnitude of improper payments became known, government officials and legislative bodies faced increased pressure to reduce them.

In Texas, for instance, the legislature was instrumental in changing in the state's benefit programs after reports of improper payments in the Medicaid program that ranged from \$365 million to \$730 million as well as in the Temporary Assistance to Needy Families and Food Stamps programs, estimated at a total of \$222.4 million. Lawmakers sought to reduce these improper payments by mandating specific actions that included use of computer technology to deter fraud and abuse.

The government has led the way in setting the stage for changes in the United Kingdom. Following Comptroller and Auditor General reports stating that the government did not know enough about the level of fraud in its benefits programs, Parliament required the Department of Work and Pensions (DWP) to improve measurement of fraud in its programs. DWP conducted a benefit review from which the government estimated that \$3 billion per year were lost to known fraud. The government further noted that if all suspicions of fraud were well founded,

the figure could be as high as \$10 billion per year. DWP proposed a strategy to reform the welfare system and reduce improper payments.

Through the process, Parliament has stayed actively involved, enacting legislation to allow data sharing between government agencies and departments. In addition, the Treasury requires departments to disclose irregular expenditures arising from erroneous benefit awards and fraud by claimants. Further, the Comptroller and Auditor General qualified his opinion on DWP's fiscal years 1995 through 2000 financial statements because of the level of fraud and error identified in the benefit programs. This served to reinforce the message that high levels of improper payments are unacceptable.

At the day-to-day level, improper payments resulting from miscalculation and other errors often receive inadequate attention. Centrelink, a "one-stop shop" that pays a variety of Australian government benefits, found through audit reports that up to 30 percent of its work was rework. The organization's management responded by implementing a "Getting it Right" strategy in 2000, setting out the roles and responsibilities of managers and team leaders as well as minimum standards for the staff to apply when making payment decisions. Centrelink distributed posters and mouse pads to reinforce the "Getting it Right" message. Centrelink's Chief Executive Officer has stated that she expects the implementation of the strategy to result in a reduction of improper payments as well as continued timeliness in payments to beneficiaries.

Study participants successfully used the following strategies to create a control environment that instilled a culture of accountability over improper payments, and could also be used at federal agencies:

- Provide leadership in setting and maintaining the agency's ethical code of conduct and in ensuring proper behavior under the code.
- Provide a cultural framework for managing risk by engaging everyone in the organization in the risk management process.
- Increase accountability by establishing goals for reducing improper payments for major programs.
- Foster an atmosphere that regards improper payments as unacceptable.

Among the organizations we studied, pressures from oversight entities and top management were instrumental in creating change. The *President's Management Agenda* and the previously mentioned legislation help define and communicate the need for improvement. By being transparent in redefining the culture, oversight entities and top management can set expectations and obtain agreement on the need for change from individuals managing day-to-day program activities.

Risk Assessment: Determining the Nature and Extent of the Problem

This culture of accountability is necessary to begin the critical next step in managing improper payments, the risk assessment process.

Strong systems of internal control provide reasonable assurance that programs are operating as intended and are achieving expected outcomes. A key step in gaining this assurance is conducting a risk assessment. This involves comprehensively reviewing and analyzing program operations to determine where risks lie and what they are, and then measuring the potential or actual effect of those risks on program operations.

The information developed during a risk assessment forms the foundation from which management can determine the corrective actions needed and provides baseline information for measuring progress. Specific methodologies for managing risk vary by organization depending on mission and the difficulty in quantifying and defining risk levels. In addition, because economic, governmental, industrial, regulatory, and operating conditions continually change, risk assessments should be updated to identify and address any new risks. The organizations that participated in our study found that conducting risk assessments to determine the nature of their improper payments was essential to helping them focus on the most significant problem and determine what needed to be done to address it.

While many federal agencies do not perform risk assessments, some do. The Department of Health and Human Services, for example, began reporting an annual estimate of improper payments in the Medicare fee-for-service program in 1996. In fiscal year 2001, it reported estimated improper Medicare fee-for-service payments of \$12.1 billion, or about 6.3 percent of such benefits. This analysis and reporting has led to the implementation of several initiatives to identify and reduce improper payments, including working with medical providers to ensure that medical records support billed services.

HUD also measures improper payments in its housing assistance programs, reporting \$1.87 billion in fiscal year 2000 and \$2 billion in fiscal year 2001. HUD has taken actions to identify the risks associated with these programs and is working to refine the procedures currently used to obtain more useful information. HUD has not, however, done risk assessments in other disbursement areas.

A thorough risk assessment allows organizations to target high-risk areas, focusing limited resources where the greatest exposure exists. The Illinois Department of Public Aid (IDPA), for instance, found that it had a payment accuracy rate of 95 percent. Its payment accuracy review identified errors and their causes that allowed IDPA to focus its attention on the 5 percent of inaccurate

payments. In doing so, it discovered that of the \$37.2 million spent for nonemergency transportation services, \$11.55 million, or 31 percent, was estimated to be in error. This discovery led to a series of actions to address this problem.

Government agencies in other countries have also used payment accuracy reviews to identify high-risk areas. For instance, the United Kingdom's DPW uses the results of rolling program reviews to determine levels of fraud and error in its Income Support and Jobseeker's Allowance benefit programs. These reviews quantify the amount of fraud and error affecting benefit claims and are used to target areas for prevention and detection.

Participants in our study used the following strategies successfully to assess risk and determine the nature and extent of improper payments. We believe that federal agencies should also consider these strategies to address improper payments.

- Institute a systematic process to estimate the level of improper payments being made by the organization.
- Based on this process, determine where risks exist, what those risks are, and the potential or actual effect of those risks on program operations.
- Use the results of the risk assessment to target high-risk areas and focus resources where the greatest exposure exists.
- Reassess risks on a recurring basis to evaluate the effect of changing conditions, both external and internal, on program operations.

Assessing risk allows an organization to set goals and target its efforts to reduce improper payments. Having developed such a framework, an organization can then proceed to determine which control activities to implement to reduce risks and, ultimately, fraud and errors.

Control Activities: Taking Action to Address Identified Risk Areas

Control activities are the policies, procedures, techniques, and mechanisms that are designed to help ensure that management's decisions and plans are carried out. Once an organization has identified and quantified the risks in its operations, and management has set a goal for reducing the risks, the organization must take action to achieve that goal. Control activities used by organizations to address improper payments vary depending on risks faced; objectives; managerial judgment; size and complexity of the organization; the operational environment; sensitivity of data; and requirements for system reliability, availability, and performance. Control activities can include both prepayment and post payment mechanisms.

Given the large volume of federal payments, it is generally more efficient to prevent improper payments rather than attempt to recover overpayments that have already been made. Recognizing, however, that some overpayments are inevitable, agencies should adopt effective detection techniques to identify and recover them. These techniques can range from sophisticated computer analyses of program data to post award contract audits and are dictated by the type of payment activity that presents the most risk in a particular organization. They include the following:

- data sharing, which allows organizations to compare information from different sources to help ensure that payments are appropriate;
- data mining, which analyzes data for relationships that were previously unknown;
- neural networking, which analyzes associations and patterns among data elements;
- recovery auditing, which is the practice of identifying and recovering overpayments using payment file information;
- contract audits, which verify that payments are being made in accordance with contract terms and applicable regulations, and
- prepayment investigations, in which contradictory information is investigated before payment is made.

Data sharing, data mining, and neural networking techniques are powerful internal control tools that provide useful, timely access to information. Using these techniques can provide potentially significant savings by identifying reporting errors and misinformation before payments are made or by detecting improper payments already made. However, more extensive use of personal information in an evolving technological environment raises new questions about privacy and how it should be protected. In the federal arena, these techniques must be implemented consistent with the protections of the Privacy Act of 1974, as amended by the Computer Matching and Privacy Protection Act of 1988, and other privacy statutes.

These techniques are an example of the types of activities that our study participants found useful. For example, in 1995, the United Kingdom formalized data matching between government organizations. It reported that through March of 2000, it had saved about \$450 million dollars. Further, from April 1999 through March 2000, data matches identified 217,000 inconsistencies for investigation, resulting in another \$53 million in benefit savings. In the United States, SSA shares information with federal agencies through more than 15 data matches to prevent and detect fraud. SSA estimates that it saves approximately \$1.5 billion each year for other agencies through data these data matches. In its own programs, SSA estimates that it saves \$350 million annually for Old Age and

Survivors Insurance and Disability Insurance and \$325 million annually for Supplemental Security Income through the use of data matching.

While data matching or sharing gives an organization the means to compare data from different sources, data mining offers a tool to review and analyze diverse data. The IDPA, for instance, had identified one of its risk areas as health care providers who were billing in excess of 24 hours in a single day. Using its data mining capability, the Illinois OIG identified 18 providers who had billed in excess of 24 hours for at least 1 day during a 6-month period. A number of these providers were already under investigation for other program violations. As a result of this analysis, the OIG planned to refer serious cases to law enforcement agencies and take administrative action against less serious violators.

Neural networking analyzes associations and patterns among data elements, allowing an organization to find relationships that can result in new queries. In Texas, models used with neural networking technology identified fraudulent patterns from large volumes of medical claims and patient and provider history data. Such models can help identify perpetrators of both known and unknown fraud schemes by analyzing utilization trends, patterns, and complex interrelationships in the data. The state currently has models for physicians and dentists and plans to initiate a model for pharmacies.

Recovery auditing, which came into use about 30 years ago, has a long-standing record in the private sector, and more recently, in the federal government.²² More extensive use of recovery auditing could offer federal agencies an opportunity to prevent and detect improper payments. One private sector company that participated in our study contracted with a recovery audit firm to review its accounts payable files. The company's own systems had found no errors in these files, yet the review resulted in the recovery of \$8 million in improper payments. Subsequently, the company began to use recovery auditing techniques on accounts payable information to prevent improper payments, through such things as identifying potential duplicate payments. During our visit, this system identified and avoided a duplicate payment of \$136,000 from the reports generated by the recovery audit software. In addition, as a result of using recovery auditing before payments are made, the company identified and stopped the processing of \$41 million in duplicative wire payments. The particular software this company uses also identifies the employees making the errors so that they can be trained appropriately.

²²Section 831 of Pub.L. 107-107 requires executive agencies that enter into contracts totaling greater than \$500 million in a fiscal year to have a program for recovering any amounts erroneously paid to contractors, including the use of recovery audits.

The organizations that participated in our study used the following strategies successfully to identify and address risks. We believe these same strategies could be used successfully by federal agencies.

- Based on an analysis of the specific risks facing the organization, and taking into consideration the nature of the organization and the environment in which it operates, determine which types of control activities would be most effective in addressing the identified risks.
- Where in-house expertise is not available, investigate the possibility of contracting activities out to firms that specialize in specific areas, such as recovery auditing and neural networking.
- Perform cost-benefit analyses of potential control activities before implementation to help ensure that the cost is not greater than the potential benefit.
- Ensure that personnel involved in developing, maintaining, and implementing control activities have the requisite skills and knowledge, recognizing that staff expertise needs to be frequently updated in evolving areas such as information technology and fraud investigation.
- Recognize and consider the importance of privacy and information security issues when developing and implementing control activities.

An agency's internal control activities should be flexible, weigh costs and benefits, and be tailored to an agency's needs. Once control activities are in place, the internal control cycle continues with the prompt communication of information that managers need to help them carry out these activities and run their operations efficiently and effectively.

Information and Communications: Using and Sharing Knowledge to Manage Improper Payments

Those responsible for managing and controlling program operations need relevant, reliable, and timely financial and nonfinancial information to make operating decisions, monitor performance, and allocate resources. This information can be obtained through a variety of sources using a wide range of data collection methodologies. The organizations that participated in our study used internal and external sources to obtain the information they needed. Further, these sources varied widely, from multiple computer databases to periodic meetings.

The need for information and communication also extends beyond organizational boundaries. Many of the governmental programs with improper payments are benefit programs that involve recipients and providers of services. Organizations in our study developed educational programs to assist these participants in understanding eligibility and other requirements, and for service providers, information on issues including common claim filing errors.

For instance, in 1997 Texas implemented several initiatives to educate new medical providers before they enroll in the Texas Medicaid program. Each new provider receives a hand-delivered package with information on claim filing, helpful tips, and instructions on how to use the automated phone system for inquiries. Three months after the provider is enrolled, a field representative from Medicaid evaluates a sample of the provider's claims and revisits the provider to answer questions and discuss any problems noted in the claims sample.

In another example, Australia's Health Insurance Commission (HIC) implemented a feedback program to provide medical practitioners with regular information about their own benefit authorization, patient demographics, and comparative statistical information showing services rendered and the dollar value of benefits paid. All 32,000 practitioners receive correspondence once a year from HIC. While at first most practitioners did not realize that HIC was able to accumulate and analyze this information, the program has now become an effective deterrent to wrongdoing as well as a desired source of information to medical providers. Some practitioners have asked for additional information or statistics prior to the annual feedback report. HIC has since established an on-line feedback and statistics site for general practitioners, 2,100 of whom accessed their reports online in 1999.

Coordination and cooperation with local law enforcement and other sources outside an agency can also establish an infrastructure conducive to preventing and detecting fraud. The IDPA OIG established a Fraud and Abuse Executive (FAE) whose objective is to be a conduit among internal and external parties for all fraud issues. As a result of cooperation between the Illinois State Police, one bank, and the FAE, thousands of dollars in fraudulent payments were stopped and a number of perpetrators were arrested.

Organizations that participated in our study used the following strategies to help them effectively use and share knowledge to manage improper payments. These strategies could also be used by federal agencies.

- Determine what information is needed by managers to meet and support initiatives aimed at reducing improper payments.
- Ensure that necessary information provided to managers is accurate and timely.
- Provide managers with timely feedback on applicable performance measures so they can use the information to manage their programs effectively.
- Develop educational programs to assist program participants in understanding program requirements.

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- Ensure that there are adequate means of communicating with, and obtaining information from, external stakeholders that may have a significant effect on improper payment initiatives.
 - Develop working relationships with other organization to share information and pursue potential instances of fraud or other wrongdoing.

Communications are effective when information flows up, down, and across an organization. In addition to internal communications, management should ensure that there are adequate means to give and obtain information from external parties who could have an effect on the agency's goals. Moreover, effective information technology management is critical. Managers need operational and financial data to monitor whether they are meeting their agency's goals with appropriate resources.

Monitoring: Tracking the Success of Improvement Initiatives

Monitoring focuses on assessing the quality of an organization's performance over time and on promptly resolving problems identified either through separate program evaluations or audits. Evaluation of an organization's programs and its successes in meeting its established goals and in identifying additional actions is an integral element of performance measurement and continued improvement in operations. Once an organization has identified its risks related to improper payments and undertaken activities to reduce these risks through internal controls, monitoring performance allows the organization to gauge how well its efforts are working.

When Illinois had assessed the risk of improper payments in its Medicaid program, based on the results, it implemented initiatives to improve payment accuracy. To monitor the effect of the new initiatives, the state uses random claims sampling to test the accuracy of payments. The goal of the project, which reviews 1,800 claims per year, is to ensure that every paid claim faces an equal chance of random review. This approach not only provides periodic estimates of payment accuracy rates but helps deter future erroneous and fraudulent billings.

Performance measures are key to monitoring progress in addressing improper payments. The government of New Zealand, for instance, requires audited statements of objectives and service performance to be included along with financial statements. These statements include performance measures related to improper payments. Work and Income New Zealand (WINZ), a government agency that provides income support and employment assistance to eligible people, has established performance measures for entitlement accuracy, services to reduce benefit crime, and debt management. WINZ's financial statements are the main accountability reports used by Parliament to monitor the agency's performance. In addition, Parliament uses the audited information to make informed decisions on resource allocation, and through a monitoring body, to hold

the entity's chief executive officer responsible if performance standards are not met.

Participants in our study used the following strategies successfully to track the success of improvement initiatives. We believe the strategies would be effective for federal agencies as well.

- Establish agency-specific goals and measures for reducing improper payments.
- Using baseline information for comparison, periodically monitor the progress in achieving the established performance measures.
- Make the results of performance reviews widely available to permit independent evaluations of the success of efforts to reduce improper payments.
- Ensure timely resolution of problems identified by audits and other reviews.
- Adjust control activities, as necessary, based on the results of monitoring activities

Organizations should monitor the control activities they use to address improper payments continuously, ingraining them in their operations. This kind of ongoing monitoring enables organizations to measure how well they are doing, track performance measures, and adjust control activities based on the results. Monitoring should also include policies and procedures for communicating review results to appropriate individuals in the organization so any problems can be resolved.

Conclusions

In closing, Mr. Chairman, I want to emphasize that high levels of improper payments need not and should not be an accepted cost of running federal programs. The organizations that participated in our study found that they could effectively and efficiently manage improper payments by (1) changing their organization's control environments or cultures, (2) performing risk assessments, (3) implementing activities to reduce fraud and errors, (4) providing relevant, reliable and timely information and communication to management on results and (5) monitoring performance over time. While HUD, Education, and other agencies have taken some steps in these areas, effectively addressing improper payments requires a comprehensive strategy that permeates the entire organization.

Implementing such a comprehensive strategy at federal agencies will not be easy or quick. It will require continued strong support from the President, the Congress, top-level administration appointees, and agency officials. The effort must include a willingness to dedicate personnel and money to implement the

changes. This could involve performing needs assessments and hiring individuals with the necessary skills and knowledge to turn planned actions into reality. In addition, many actions that proved successful for organizations in our study involved computer assisted analyses of data. Implementing some of these practices could involve funding for computer software or hardware, and additional staff or training.

In addition, it is important that the results of actions taken to address improper payments be openly communicated not only to the Congress and agency management, but to the public. This transparency demonstrates the importance that government places on the need for change at the same time it openly communicates performance results. It also acts as an incentive for agencies to be ever vigilant in their efforts to address wasteful spending that results from weak controls that lead to improper payments.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other Members of the Subcommittee may have.

Contact and Acknowledgments

For information about this statement, please contact Linda Calbom, Director, Financial Management and Assurance, at (202) 512-9508 or at calboml@gao.gov. Individuals making key contributions to this statement include Dan Blair, Don Campbell, Lisa Crye, Anh Dang, Bonnie Derby, Kelly Lehr, Carla Lewis, Sharon Loflin, Irving McMasters, Diane Morris, Andy O'Connell, Russell Rowe, Ruth Walk, Brooke Whittaker, and Doris Yanger.

(190042)

Mr. HORN. Thank you. The reporter will put in the Managing Improper Payments through Internal Controls with the various segments, control, environment, monitoring, risk assessment, information and communications, control activities, with the objective of manage improper payments.

We will now go with the second witness, the Honorable Angela M. Antonelli, Chief Financial Officer, Department of Housing and Urban Development. Thank you for being with us.

STATEMENT OF ANGELA M. ANTONELLI, CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. ANTONELLI. Thank you, Mr. Chairman.

Mr. Chairman, thank you for the opportunity to appear before you today to discuss HUD's initiatives to identify and reduce erroneous payments. Every dollar that HUD pays in error is a dollar that is not available to serve the intended low-income beneficiaries of our housing and community development programs.

Improved financial performance, including erroneous payment reduction, is a key components of the President's management agenda. HUD Secretary Mel Martinez and his leadership team are focused on meeting the President's goals. I am pleased to report that HUD is making real progress in strengthening internal controls and reducing the risk of erroneous payments. And I applaud your efforts, Mr. Chairman, to aggressively tackle this issue.

I am pleased to appear before you today with Jack Martin, the CFO at Education, as well as Linda Calbom from GAO. As I'm sure my colleague from Education will agree, GAO and its fine staff, like Linda Calbom, have issued very useful guidance for more effective management of erroneous payments by Federal agencies. The GAO's extensive audit work at HUD also has been instrumental in identifying vulnerable areas in need of stronger internal controls to reduce the risk of erroneous payments. My testimony today will focus on two such areas reviewed by GAO.

Before I continue, I would like to request that my more detailed written statement be submitted for the record.

Mr. HORN. I should have said in advance, it automatically goes in the record once you are noted. All of that goes in.

Ms. ANTONELLI. Thank you.

I would also like to introduce two people who are with me. Behind me are seated Vickers Meadows, HUD's Assistant Secretary for Administration, and John Weicher, HUD's Assistant Secretary for Housing and the FHA Commissioner.

First, I want to discuss HUD's efforts to reduce the risk of erroneous payments in its Government credit card program. I'll first start with our travel card to illustrate what I believe HUD can accomplish with strong leadership and an effective plan. This was a good place for Secretary Martinez and his new leadership team to start to create a culture of accountability at HUD.

When I became HUD's CFO in mid-July 2001, HUD had a recognized payment delinquency problem in its travel credit card program. We took aggressive action that included staff training, travel payment system improvements, and the use of salary offsets for more egregious cases. We also began to produce monthly delin-

quency reports that the Deputy Secretary distributed for followup and action at monthly executive management meetings with all of HUD's assistant secretaries. I'm proud to say that action reduced the monthly balance of delinquencies over 60 days and reduced it by 96 percent.

In July 8, 2002, in the Federal Times, HUD and the Department of Justice were reported as tied for first place with the lowest travel card delinquencies, with only 1 percent delinquent, versus a 6 percent Government-wide average. It's clear HUD's travel card users now understand the rules and follow them with appropriate management oversight to assure they do.

The story on HUD's purchase credit card program is not yet as good. But it will be. HUD's Office of Administration administers the purchase credit card program. HUD's new Assistant Secretary for Administration was not confirmed to serve in her position until March 2002. She will provide leadership in this area. Earlier this year, the Director of OMB requested all agencies to review the adequacy of their internal controls over purchase card use and establish remedial action plans to address deficiencies. Working with OMB, HUD's Office of Administration developed plans for stronger program controls and increased oversight.

However, HUD's GAO briefing on the results of their audit of HUD's \$10 million fiscal year 2001 purchase card activity disclosed the need to strengthen controls and oversight immediately, and we've begun to do so. Of particular concern was the GAO's finding on purchase card holders failing to maintain adequate documentation in support of their purchases. The Office of Administration has initiated interim action to advise all purchase card holders of the need to use a designated HUD form to clearly document a description of the purchase, the business need for the purchase and the required approvals. Also, a staff person has now been assigned to work exclusively on the internal audit functions of the program. Failure to maintain required documentation and obtain required approvals will result in the card holder's loss of the purchase card and possible other appropriate disciplinary action.

HUD staff will be fully accountable for the purchase card program activity and our goal is to establish a model purchase card program in fiscal year 2003. I am confident we will achieve this.

The GAO also recently performed a vulnerability assessment and audit of payments for contracted services for the management and maintenance of HUD-owned multi-family housing property inventory. The GAO detected possible fraud. Pending conclusion of an investigation by GAO and HUD's IG, HUD does not have complete information at this time on the specifics of the GAO review, and has been restricted in its ability to pursue any necessary followup actions on the activities now under investigation. Nevertheless, the Office of Housing is proactively analyzing its existing contract activity to determine if there are other, similar circumstances requiring immediate attention.

In addition, even before GAO's reporting of the preliminary results of its review, the Office of Housing had already initiated several actions that would bring greater control and accountability to the property management control activity. These actions are designed to collectively establish a strong quality control program for

HUD's existing property management contracts and new contracts to begin in January 2003. The actions strengthen HUD's oversight of all property management contractor activity, as well as the property management contractors' oversight of their own subcontractor activity. Further details on these actions are provided in my written statement.

Mr. Chairman, HUD embraces the content of GAO's October 2001 executive guide on strategies to manage improper payments. As the GAO has referenced in recent testimony and reports to Congress, HUD's current administration is already well underway, taking action and doing well to address erroneous payments in its largest program area, rental housing assistance. Our rental housing assistance program constitutes over two-thirds of HUD's budget authority, with over \$21 billion of expenditures in fiscal year 2001. And in fiscal year 2001 financial statements we reported an estimated net annual housing assistance overpayment of \$2 billion. We will continue to improve these estimates. In addition, the President's management agenda has set a goal for a 50 percent reduction in that amount by 2005.

HUD also will need congressional support to reduce the overpaid housing assistance. As noted in the OMB testimony submitted for the record, of particular importance is the need for statutory authority to perform computer matching with available Federal sources of income data for use by HUD and HUD's program administrator in correctly calculating housing assistance.

Mr. Chairman, HUD will continue to focus on reducing the risks of erroneous payments in its rental housing assistance program area, and to address other internal control deficiencies identified by the GAO and our IG. In addition, we will increase the efforts of HUD managers to assess erroneous payment risks in other areas and to strengthen controls.

That concludes my remarks, and I would be happy to answer any questions.

Thank you.

[The prepared statement of Ms. Antonelli follows:]

STATEMENT OF ANGELA M. ANTONELLI
Chief Financial Officer
U.S. Department of Housing and Urban Development



BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY,
FINANCIAL MANAGEMENT, AND INTERGOVERNMENTAL
RELATIONS

OCTOBER 3, 2002

“REDUCING THE RISK OF IMPROPER PAYMENTS”

Chairman Horn and Subcommittee members, I thank you for the opportunity to appear before you today to discuss the U.S. Department of Housing and Urban Development’s (HUD) initiatives to identify and reduce erroneous payments. Every dollar that HUD pays in error is a dollar that is not available to serve the intended low-income beneficiaries of our critically needed housing and community development programs. Reducing erroneous payments is a priority for Secretary Mel Martinez and his leadership team at HUD. I applaud your efforts, Mr. Chairman, to reduce erroneous payments by the Federal government.

I am pleased to appear before you today with representatives from the U. S. Department of Education and the U. S. General Accounting Office (GAO). HUD and other agencies are focused on erroneous payment reduction to improve financial performance under the President’s Management Agenda. The GAO has provided useful guidance for more effective management of erroneous payments by Federal agencies. The GAO’s audit work at HUD has also been instrumental in identifying vulnerable areas in need of stronger internal controls to reduce the risk of erroneous payments. I am pleased to report that HUD is making real progress in strengthening internal controls and reducing the risk of erroneous payments. My testimony today will focus on HUD’s efforts to reduce the risk of erroneous payments in two known areas of vulnerability—government credit cards and multifamily housing property management services—and to better manage improper payments in all programs in the future.

Government Credit Cards

Under the direction of the Office of Management and Budget (OMB), there has been a government-wide focus on reducing travel and purchase credit card abuse by Federal employees. HUD had a recognized travel credit card payment delinquency problem when I became HUD’s CFO in July of 2001. My office administers HUD’s Travel Credit Card Program and I believe that aggressively addressing such issues is important in creating a culture of accountability at HUD. In September 2001, the Department had travel card delinquency balances in excess of 60 days totaling \$389,000. The Secretary made it clear that this was completely unacceptable. Our corrective actions included: automating our travel form processing to improve the timeliness of travel voucher payments to staff, educating our staff on travel regulations, strengthening our management oversight of payment delinquencies, and using administrative payroll off-set or wage garnishment for egregious cases. The Department has been tracking travel delinquencies every month since September 2001, and I am pleased to report that our aggressive actions reduced the monthly delinquent balance to a current figure around \$15,000 per month. This is a 96 percent reduction from the September 2001 delinquency amount.

As reported in the July 8, 2002 issue of the *Federal Times*, HUD and the Department of Justice are tied for first place with the lowest travel card delinquencies,

with only 1 percent delinquent versus a 6 percent government-wide average. It is clear HUD's travel card users now understand the rules and follow them, with appropriate management oversight to assure they do.

HUD's story on its Purchase Credit Card Program is not yet as good, but it will be. HUD's Office of Administration administers the purchase card program. The new administration's Assistant Secretary for Administration, who is providing necessary leadership in this area, was not confirmed until March of 2002.

On April 18, 2002, the Director of OMB requested that all agencies review the adequacy of their internal controls over purchase card use and establish remedial action plans to address any deficiencies identified. The remediation plan developed by HUD and approved by OMB included the following actions to strengthen controls and reduce the risk of erroneous payments:

- Enhanced Program Management Capacity - through an increase in the number of staff with responsibility for: credit card account management, monitoring transactions, training cardholders and approving officials, conducting internal audits and reviews, and preparing credit card policies and procedures. HUD has already assigned a staff person to perform internal audits of purchase card program activity to assure compliance with requirements.
- Increased Use of Automated Monitoring Tools - by coordinating with the servicing bank to develop a rollout plan to train cardholders, approving officials, and reviewers on the use of the automated credit card system at their respective access levels. Use of the automated credit card system will greatly enhance the monitoring effort. Cardholders will be able to review and run reports on their transactions, enabling them to quickly detect errors and initiate the dispute process. Approving officials can manage more efficiently with the ability to review cardholder statements in real time versus 30 days after the purchase. Daily monitoring by program administration staff can ensure that instances of long-term cardholder abuse do not occur, and that split purchases are detected and eliminated. Frequent organizational audits will ensure that all organizations within HUD are being reviewed and monitored on a regular and consistent basis.
- Improved Program Guidance and Communication - by creating a handbook supplement to synopsise cardholder and approving official responsibilities and clearly defining each level of accountability. The supplement will contain a comprehensive list of the penalties for various types of misuse, abuse, and fraud to raise staff awareness. It will also include a checklist of dos and don'ts of the purchasing and approval process that will be required to become part of the files maintained on each credit card transaction. Cardholders and approving officials will be required to certify that they have read and understood the content.

- *Validation of Purchase Card Need* - through periodic reviews of the use of each purchase card to verify that the need for the card is still valid, the spending limits are appropriate for the purchasing needs, and the delegations of authority for single purchase spending limits above \$2,500 are current. This will be achieved by reviewing past transactions and interviewing cardholders, approving officials, and budget staff, as necessary. The assurance that all cards are necessary and are designated to purchase specific goods or services will make the monitoring effort less cumbersome and make purchasing irregularities easier to detect. Top-level management will be actively involved in the oversight of the program and held accountable for the cards assigned to his/her program area. We will take immediate corrective actions, where needed, to include closing accounts, decreasing or increasing spending limits, changing cardholders and approving officials, etc.

In early July 2002, the GAO briefed HUD on the results of their erroneous payments vulnerability assessment on HUD's \$10.2 million of purchase card program activity in fiscal year 2001. GAO advised HUD of four internal control deficiencies observed during their review. In essence, HUD's system of internal control in fiscal year 2001 did not provide reasonable assurance that: 1) adequate supporting documentation was maintained for individual purchases, 2) individual purchases were properly reviewed and approved, 3) split purchases were prohibited, and 4) records on purchase cardholders and approving officials were current and accurate. While HUD made some program improvements in fiscal year 2002, such as blocking Merchant Category Codes that are clearly not business related, we acknowledge the need to strengthen our purchase card controls to address the issues raised by the GAO.

HUD views the GAO finding on the lack of adequate supporting documentation for purchase card purchases as a serious matter of non-compliance with existing purchase card program requirements. As a result, the Office of Administration has initiated interim action to advise all purchase cardholders of the need to use the HUD Form 10.4, "Requisition for Supplies, Equipment, Forms, Publications and Procurement Services" to clearly document a description of the purchase, the business need for the purchase, and the required approval of the purchase. Failure to maintain such required documentation would result in the cardholder's loss of the purchase card and possible other appropriate disciplinary action.

HUD will work with the GAO and the OMB to further improve its purchase card program remediation plan to include other actions that will fully address the issues raised by the GAO. The Office of Administration has begun implementation of its remediation plan and our schedule for completing implementation has been expedited in light of the GAO's findings on the risks apparent in fiscal year 2001. I believe that the implementation of these new strategies and procedures will strengthen our processes and controls to adequately reduce the risk of erroneous payments in HUD's Purchase Credit Card Program.

Multifamily Housing Property Management Services

The GAO also recently performed a vulnerability assessment of payments for contracted services for the management and maintenance of the HUD-owned multifamily housing property inventory. At GAO's first presentation of its findings to the Department, GAO informed the HUD staff that GAO's Office of Special Investigation and HUD's Office of the Inspector General (OIG) had begun an investigation of the GAO findings. The GAO advised HUD not to pursue any of the project specific findings or question any of the contractors regarding the GAO findings because of the ongoing investigations. Based on the continuing investigation, it was not possible for HUD staff to review many of the project specific findings, and we are therefore not able to comment on them. However, I can discuss the procedural changes that are underway at HUD and have been underway for several months.

The GAO review indicated deficiencies in the Department's oversight of the contracts for property management services. Prior to the GAO's reporting of the results of its review of the multifamily property management activities, the Department had already initiated several actions that would bring greater control and accountability to these functions. The GAO assessment reinforced the need for better internal controls and more detailed oversight of the property management contracting activities.

In the next several weeks, HUD staff will be revising the guidance and policies and procedures in reference to the Department's oversight of these property management contracts. The Department will be adding additional controls (e.g., a semi-annual audit of each contractor), conducting additional Government Technical Monitoring and Government Technical Representative training for HUD staff, and providing clearer and more concise guidance.

Since the GAO conducted its initial reviews with HUD's Atlanta and Fort Worth Property Disposition Centers and discussed its areas of concern, the Department has modified the current contract with the property management Oversight Contractor to include new inspection and procurement assessment requirements that will assist the Centers in their oversight of the Property Management Contractor's procurement activities. The new requirements require the Oversight Contractor to perform the following activities:

- Review the Property Manager's procurement activities, including subcontracting activities.
- Perform on-site reviews of subcontract work, services, and deliverables to assure compliance with the terms and conditions of the Property Managers' subcontracting requirements, on a random sampling basis.
- Perform on-site comparisons of subcontractor billings to work performed, on a random sampling basis.

- Review the Property Manager's subcontracting file documentation and on-site invoices to assure that work orders were not deliberately split to avoid competition and/or HUD approval.
- Perform physical inspections of completed subcontracted work to compare work orders to actual work performed, and produce both written and photographic records of significant work items actually completed, on a random sampling basis.

Notwithstanding GAO's request to not conduct specific inquiries into the issues raised in the GAO review, the magnitude of these property management contracting activities required HUD to take some very proactive steps to assure that on-going procurement activities were and are being properly performed. The Atlanta Property Disposition Center's staff have begun analyzing a voluminous printout that lists all the purchase orders issued by the Center's Property Management Contractor to determine if the contractor is conducting its procurement activities under the terms of the Property Management Contract. Where irregularities are found, they will be brought to the contractor's attention for appropriate action. Additionally, upon completion of the HUD OIG and GAO investigations, the Atlanta Property Disposition Center will contact the contractor and address the irregularities identified in the GAO's report.

HUD is in the process of procuring new property management contractors nationwide to manage the mortgagee-in-possession and HUD-owned properties. These new contractors should begin work on January 1, 2003. The Department has significantly strengthened the requirements for oversight and management in the new property management contracts that are out for solicitation. The new contracts have increased the contractor's oversight responsibilities, particularly in the areas of quality controls and subcontracting activities. Some of these new requirements include:

- Provide an upfront Quality Control (QC) Plan for the overall operation of the Property Management Contract. The Plan will establish written procedures to monitor work assignments of employees and subcontractors, inspect work completed, and ensure compliance with the Property Management Contract as well as Federal, state, and local laws and regulation.
- Provide photographic documentation to accompany all inspections of significant work or subcontracted work.
- Perform yearly audits of on-site subcontracting activities, on a project-by-project basis.

Other revisions were made to the new contract documents to better address the Department's need for improved quality control under these contracts, such as:

- A definition of what constitutes an emergency repair, which was lacking in the old Property Management Contracts. (Emergency repair is defined as a situation where

life, health or property is in danger and immediate action is needed to eliminate or mitigate the dangerous conditions.)

- Additional language to emphasize the importance of procurement planning to avoid costly emergency acquisitions.
- The use of long-term, indefinite delivery subcontracts to consolidate the purchase of routine supplies and recurring services.
- An expanded list of the types of documents to be included in subcontract files.
- Expanded requirements for monthly subcontracting reports and inspection requirements.
- The Property Manager must conduct internal audits of the subcontracting activities performed at each project site and submit annual reports to HUD's Contracting Officer.

The combination of these actions to improve the quality control activities of HUD staff, HUD's Oversight Contractor and the Property Management Contractors themselves, will greatly reduce the risk of erroneous payments in the Department's future multifamily property management activity.

Management of Erroneous Payments

While the focus of today's hearing was on the GAO's erroneous payment vulnerability assessment work at HUD and the Department of Education, it is important to note that HUD is addressing erroneous payments in areas other than its government credit card and multifamily housing property management contracting. HUD embraces the content of the GAO's October 2001 Executive Guide on "Strategies to Manage Improper Payments – Learning From Public and Private Sector Organizations." As referenced in the GAO's August 2002 report on "Financial Management - Coordinated Approach Needed to Address the Government's Improper Payments Problems," HUD is addressing erroneous payments in its largest programs area—rental housing assistance.

The rental housing assistance programs area constitutes over two-thirds of HUD's budget authority, with over \$21 billion of expenditures in fiscal year 2001. Our actions to identify and address erroneous payments in this programs area closely follow the model espoused in the GAO guide on managing erroneous payments. In this regard, we have established a baseline error measurement. The combined effect of the estimated assistance overpayments and underpayments attributed to program administrator processing errors and tenant underreporting of income yielded a net annual assistance overpayment estimate of over \$2 billion. Secretary Martinez established a Department-wide task group to develop a comprehensive strategy to address the underlying causes of these erroneous payments. This strategy calls for the provision of improved program

guidance and training, development of automated processing tools, increased income data sharing, enhanced incentives and sanctions, the pursuit of program simplification, and increased monitoring. The Department will continue to track, measure and report on its progress in reducing these erroneous payments. The President's Management Agenda establishes an overall goal of a 50 percent reduction of the estimated \$2 billion in net annual overpaid rental housing assistance by 2005. HUD will need the support of OMB and the Congress to provide us the tools and resources needed to meet this goal. Of particular importance is the need for statutory authority to perform computer matching with available Federal sources of income data for use by HUD and HUD's program administrators in correctly calculating housing assistance.

HUD's leadership places a strong emphasis on high ethical standards and accountability in our program administration. We will continue to focus on reducing the risk of erroneous payments in our rental housing assistance programs area and to address other internal control deficiencies identified by the GAO and OIG. In addition, we will increase the efforts of HUD managers to assess erroneous payment risk in other areas, and to strengthen controls where it is cost-beneficial and feasible within HUD's budgetary resources.

That concludes my testimony. I look forward to working with the OMB, the GAO and the Congress in the continued pursuit of cost-effective solutions for identifying and reducing erroneous payments at HUD.

Mr. HORN. Thank you.

We will now go to the Honorable Jack Martin, Chief Financial Officer for the Department of Education.

**STATEMENT OF JACK MARTIN, CHIEF FINANCIAL OFFICER,
U.S. DEPARTMENT OF EDUCATION**

Mr. MARTIN. Mr. Chairman, and members of the subcommittee, good afternoon. I want to thank you for the opportunity to discuss the Department of Education's progress toward improving financial management, including the reduction of improper payments and instituting an improved culture of accountability. I would also like to thank you for your continued efforts in helping Federal agencies identify and address management problems and supporting our efforts to improve the overall efficiency and management of Government operations, particularly in the area of financial management.

The Department supports the need to effectively address the issue of improper payments in the context of improving the overall financial management of Federal programs. Recognizing the work of the General Accounting Office, the Inspector General community and others, the President's Management Agenda initiative for improved financial performance specifically identifies erroneous payments as a critical problem that needs to be addressed by Federal agencies. To insure a coordinated approach to erroneous payments Government-wide, OMB, through the Chief Financial Officer's counsel, established an erroneous payments committee approximately 1 year ago. This committee's membership is comprised of staff from more than a dozen CFO Act agencies. The Department's Deputy CFO chairs this committee.

The President's Management Agenda directs agencies to establish baselines on the extent of erroneous payments within the Federal Government. In their fiscal year 2003 budget submissions, Federal agencies were required to include information on erroneous payment rates in the form of actual rates, as well as targeted rates of reduction for benefit and assistance programs over \$2 billion. For the first year of reporting, the Department of Education was required to provide information on four program areas: Title I, special education grants to States, vocational rehabilitation grants to States, and student financial assistance. We have established at the Department specific annual targets for the reduction and/or elimination of both the numbers and amounts of erroneous payments by 10 percent per year through fiscal year 2007. Secretary Paige has assigned me the responsibility for establishing policies and procedures for assessing agency and program risks of improper payment, assuring actions are taken to reduce those payments and reporting the results of the actions taken.

We have made much progress to date. In response to specific concerns raised in GAO's recent audit reports, we have taken additional measures to strengthen our internal controls, including a 2-hour internal control training course for all Department employees and an 8-hour internal control course for all Department managers. With respect to purchase cards, we have implemented new policies and procedures to reduce the Department's vulnerability to future improper purchases. We issued a revised Procedures Directive in January 2002 that provided instructions to card holders and to ap-

proving officials who are responsible for reviewing and approving purchase card transactions.

We have trained all approving officials and all alternate approving officials in the new procedures and have increased the number of approving officials and program officers where disbursement reviews were considered inadequate. We have accepted GAO's suggestion and are conducting compliance reviews of a random sample of purchase card transactions. As of September 30, reviews have been conducted of all Department Program Offices at headquarters and in all regional offices. A quarterly review is ongoing. These reviews will ensure that purchases are not above thresholds and that there are no split purchases, that goods and services were properly received and accepted, and that appropriate separation of duties existed between the card holder and the approving official.

The Department has blocked more than 300 Merchant Category Codes for purchase cards that are clearly not business related or appropriately chargeable to a purchase card. In addition, computer equipment cannot be purchased on a purchase card without the consent of the Office of the Chief Information Officer and new policies have been designed to maintain control over the procurement of computers and related equipment.

We also initiated data mining technology to proactively identify potential improprieties in purchase card use and payments. By January 2003, we anticipate expanding data mining to analyses to identify potential improprieties in travel cards. We believe that all of these efforts will be effective in eliminating the types of abuse that GAO and the IG noted in our purchase card process.

But we can't stop there. So we continue to communicate to our employees and managers as well as our delivery partners the importance of these and future internal control initiatives.

Turning now to Federal Student Aid [FSA], GAO's financial management audit report of the Program's loan and grant disbursements found that four schools disbursed \$3.4 million in Pell Grants to ineligible students. While this represents a very small percentage of the FSA disbursements that GAO reviewed, the Department recognizes the importance of identifying and correcting the underlying causes of internal control weaknesses that allowed these erroneous payments.

Thus, FSA has begun to perform various types of data analysis to identify areas where problems may exist. Working with GAO, FSA has adopted techniques to locate unusual concentrations of students with particular characteristics, has determined what the norm is for concentrations of such students and has begun to determine what constitutes abnormal concentrations which warrant further review. Cases where fraud and abuse are suspected are referred to the OIG.

FSA routinely conducts matches with the Social Security Administration to ensure that applicants have valid Social Security numbers. In fiscal year 2000, we enhanced our student eligibility edits by matching information supplied on the application for Federal student aid with the Social Security Administration's dead file to intercept attempts to secure Federal funding using a false Social Security number. In addition, the Department's Central Processing System [CPS] performs pre-screening matches to ensure that appli-

cants who are in default on Federal loans or who owe over-payments of Federal grant funds do not receive additional funds.

Hundreds of millions of dollars of potential improper payments a year are averted because of these matches. The Secretary has set as one of his highest priorities the goal of getting the student financial assistance programs off the GAO list of high risk programs. But to do that, we need Congress' help. In 1998, as part of the reauthorization of the Higher Education Act of 1965, Congress authorized a data match with the Internal Revenue Service on student aid applicant data. However, because return information may not be disclosed to third parties unless authorized by the Internal Revenue Code of 1986 itself, the match described in Section 484(q) of the Higher Education Act could not be implemented. Section 6103 of the Internal Revenue Code must be amended to allow for this critical verification.

In early June 2002, Treasury informally provided draft legislation to the Joint Committee on Taxation for technical review that would address this issue. The Director of OMB and the Secretaries of the Treasury and Education formally transmitted the proposed amendment to Congress on August 9, 2002. Staff from Treasury and Education are currently identifying and agreeing on processes and procedures to support the match once authorized, including necessary followup with applicants and schools in a manner that will protect the privacy of the taxpayer in accordance with the proposed legislation.

Implementation of the proposed data match between the Department and IRS has the potential to ultimately eliminate over \$300 million in erroneous payments in the Federal Pell Grant program each award year. I urge Congress to consider this proposal in the near future.

I believe our efforts thus far demonstrate our firm commitment to address the overall problems of improper payments and to complete necessary improvements in the administration of the Department's programs. They have strengthened internal controls throughout the Department. We are actively monitoring the use of purchase cards and analysis of travel expenditures. In our student financial assistance programs, we have a very clear focus on integrating systems, maintaining critical accountability while improving customer service, demonstrating a balanced yet accountable school monitoring approach and addressing quickly suspected anomalies in the payment of funds to recipients.

We will periodically report on our progress in reducing erroneous payments to OMB and the Congress, as well as announcing any future plans for controlling improper payments.

I would like to close by saying that our management improvements have clearly put us on a very positive course toward our goal of becoming a model agency of management and program excellence. I have come before you today with confidence to assure you that corrective actions are being well targeted throughout our Department.

This concludes my testimony. I will be happy to answer any questions you may have.

[The prepared statement of Mr. Martin follows:]

DEPARTMENT OF EDUCATION

Statement by Jack Martin

Chief Financial Officer

On

Improper Payments

October 3, 2002

Mr. Chairman and Members of the Subcommittee:

I want to thank you for the opportunity to discuss the Department of Education's progress towards improving financial management, including the reduction of improper payments, and instituting an improved culture of accountability. I would also like to thank you for your continued efforts in helping Federal agencies identify and address management problems, and supporting our efforts to improve the overall efficiency and management of government operations, particularly in the area of financial management. The Department supports the need to effectively address the issue of improper or erroneous payments in the context of improving the overall financial management of Federal programs.

Recognition of Issue and Department Strategy

Recognizing the work of the General Accounting Office (GAO), the Inspector General (IG) community and others, the President's Management Agenda (PMA) initiative for Improved Financial Performance

specifically identifies erroneous payments as a critical problem that needs to be addressed by Federal agencies.

The PMA directs agencies to establish baselines on the extent of erroneous payments within the Federal government. In their FY 2003 budget submissions, Federal agencies were required to include information on erroneous payment rates in the form of actual rates as well as targeted rates of reduction for benefit and assistance programs over \$2 billion. For the first year of reporting, the Department of Education was required to provide information on four program areas: Title I, Special Education Grants to States, Vocational Rehabilitation Grants to States, and Student Financial Assistance.

The Financial Performance initiative, as well as a specific Department of Education PMA program initiative to eliminate fraud and error in the student financial assistance programs, both address a long outstanding problem regarding the need for the Department to better verify income used in determining eligibility for student financial assistance. We expect that these PMA initiatives will result in, among other things, the reduction of erroneous payments to students, thereby ensuring that hundreds of millions of dollars of aid is better targeted to the neediest students and further increasing the public's confidence in the integrity of Federal student aid programs.

Our Strategic Plan for FY 2002-2007 was specifically designed to support the President's vision for education in the United States - to leave no child behind - and the initiatives in the President's Management Agenda. The Strategic Plan contains six strategic goals. Strategic Goal Six, Establish Management Excellence throughout the Department of Education, is specifically aligned with the PMA initiatives.

Goal Six was built upon the work started when we first identified the need to radically improve the Department's financial management and institute a culture of accountability across the Department. In April 2001, Secretary Paige established a Management Improvement Team of senior career managers to identify, resolve, and close our outstanding management improvement recommendations, and to develop a blueprint to address longer term and structural issues that hindered the efficient and effective performance of the Department. The Blueprint for Management Excellence, which was released in October of 2001, demonstrates our commitment to excellence and contains plans to realize further improvements and create mechanisms for achieving accountability and high performance throughout the Department.

With our Strategic Plan, and the implementing Annual Plan for FY 2002-2003, we show how we will make performance the basis of every program decision. In the area of erroneous payments, we have built upon the initial actions identified in the Blueprint by establishing specific annual targets for the reduction and/or elimination of both the numbers and amounts of erroneous payments by 10% per year through FY 2007 (Strategic Plan - Performance Object 6.1). The Secretary has assigned me the responsibility for establishing policies and procedures for assessing agency and program risks of improper payments, ensuring action is taken to reduce those risks and payments, and reporting the results of the actions taken.

By January 2003, we will complete a schedule for development of detailed action plans to determine the nature and extent of possible improper payments for the remainder of the Department's programs and activities that expend Federal funds. Inherent in these action plans is the identification of critical data analysis capabilities within financial and program management systems to provide up-to-date information for either

program action or referral of suspected fraud to the Office of Inspector General (OIG) (Strategic Plan – Performance Objective 6.1). In recognition of the need for continued analysis of erroneous payments in the program and administrative areas, we will be conducting annual reviews of our internal controls consistent with the Federal Managers' Financial Integrity Act process. We are also developing and will implement action plans to ensure that discretionary and formula grant programs operate with the highest level of efficiency, effectiveness, and integrity.

We have also established specific annual targets for the reduction of Pell Grant overpayments through FY 2007, in recognition of the issues identified in our student financial assistance programs eligibility process (Strategic Plan – Performance Objective 6.4). The specific action plan to reduce award error in the Pell Grant Program incorporates initiatives to improve administration through analysis, measurement, oversight, and monitoring. In addition to our request for a legislative change outlined below, we will be developing methodologies to improve our student eligibility verification process. We are continuing our development of a more efficient and integrated student aid delivery system using new technologies, thereby eliminating, reengineering, or replacing the fourteen legacy systems in operation at the beginning of our modernization effort by FY 2004. These changes will improve service, cut costs and reduce the incidence of improper payment of student aid funds.

As we are performing our analysis and preparing our action plans, we will identify cost-effective methods for addressing identified risk areas. However, it is important to note that the process of identifying and monitoring program payments for potential errors does not come without costs. Therefore, that the resources for these actions need to be addressed concurrently with the issue of improper payments.

Collaboration with Other Agencies

Including the erroneous payment reduction goals in our Strategic and Annual Plans not only formalizes our commitment to the effort, but also provides the Subcommittee and others a highly visible way with which to monitor our progress. As the Department has discussed these issues and how to measure improvement with the Office of Management and Budget (OMB), GAO and others, it has become increasingly clear that agencies need to be working together to identify the true magnitude of this problem, and resolve it effectively.

To ensure a coordinated approach to erroneous payments government-wide, OMB, through the Chief Financial Officer's Council (CFOC), established an Erroneous Payments Committee approximately one year ago. This committee's membership is comprised of staff from more than a dozen CFO Act agencies. Mark Carney, the Department's Deputy CFO, chairs this committee.

Early in the process, the Department's IG suggested a collaborative approach for bringing this mutual area of concern under control. Thus, the CFOC/PCIE Improper and Erroneous Payments Workgroup (Workgroup) was formed. In recognition of the importance we place on this initiative, the Department's Deputy CFO and Acting IG are co-chairing this group. With OMB's support and leadership, the Workgroup is developing specific strategies and benchmarking methods to reduce or eliminate, where possible, improper and erroneous payments. Several tasks are being carried out to aid in the consistent identification of and measurement of this problem throughout the government. Workgroup members are also hearing about best practices from best-in-business entities and contractors on how to improve performance in this area and identify and

reduce potential erroneous payments. Products prepared by the Workgroup will also support agencies and oversight bodies to better monitor and fairly compare the extent of erroneous payments by agency throughout the government.

In our opinion, the Department's actions and the Workgroup plans in these areas address many of the recommendations made by GAO in its August audit report entitled "Coordinated Approach Needed to Address the Government's Improper Payments Problems." The Secretary and OMB are very committed to our progress in reducing erroneous payments, and will be actively monitoring that progress. We will also strive to keep the Congress informed of that progress, as well as any future plans for controlling erroneous payments.

Department Actions to Address Specific Issues

In response to the specific concerns raised in the GAO's March 2002 audit, "Weak Internal Controls Led to Instances of Fraud and Other Improper Payments," prior GAO reports issued in 2001, and work performed by the OIG, we have taken additional measures to strengthen our internal controls. Most importantly, we have begun analyzing our data more systematically to establish baselines and indicators, thus allowing us to focus our resources more efficiently.

Purchase Cards. As a result of the GAO audit and OIG work, new policies and procedures were implemented aimed at reducing the Department's vulnerability to future improper purchases. We issued a revised procedures directive in January 2002, which provided instructions to cardholders and to Approving Officials who are responsible for reviewing and approving purchase card transactions. With the Department's new electronic reconciliation and payment approval process,

the cardholder is required to provide reports to the Approving Official that document the cardholder's transaction activity for the billing period and the hard copy receipts for all purchases. Further, the Office of the Chief Financial Officer (OCFO) distributes monthly management reports to each Principal Officer to enable review of his or her office's cardholder purchase card transaction activity.

OCFO has trained all Approving Officials and all Alternate Approving Officials in the new procedures. OCFO has accepted GAO's suggestion and is conducting internal control reviews and quality reviews of random sample purchase card transactions on a quarterly basis to:

- a) ensure that purchases above the micro-purchase threshold of \$2,500 are being made only by warranted officials;
- b) review the appropriateness of purchases, including determining that individual purchases are appropriate, that the goods and services were properly received and accepted, and that payment was proper through the review of Merchant Category Codes (MCC);
- c) ensure appropriate separation of duties between the cardholder and the Approving Official;
- d) ensure that requirements are not split into multiple purchases to circumvent procurement rules that apply to purchases exceeding the micro-purchase threshold, or to circumvent purchase card limits; and
- e) review the number of Approving Officials in each ED office so that no Approving Official is required to review an inordinate number of purchases each month.

As part of the effort to improve internal controls over the purchase cards, the Department has blocked more than 300 MCCs. Examples of blocked merchant categories include: wire transfer money orders, veterinary

services, airplane and car rentals, taxis and limousines, airline carriers and banks. As discussed, OCFO will utilize MCC data to identify potential transactions subject to restrictions when using the purchase card, or to identify additional MCCs that may track to improper purchases. Finally, computer equipment cannot be purchased on a purchase card without the consent of the Office of the Chief Information Officer, and new policies were designed to maintain control over the procurement of computers and related equipment.

We believe that all of the efforts described above will be effective in eliminating the types of abuses that GAO and OIG noted in our purchase card process, and we continue to communicate with our employees and managers, as well as our delivery partners, about the importance of these and future internal control initiatives. In addition, we initiated data mining technology to proactively identify potential improprieties in purchase card use and payments, and, this month we anticipate expanding data mining analysis to identify potential improprieties in travel cards. This year we also required all Department employees to complete a two-hour internal control training course, and Department managers were required to complete a more extensive eight-hour internal control training course. These efforts will enhance our ability to improve internal controls necessary to minimize the Department's vulnerability to future improper payments.

Student Financial Assistance. The Department's Inspector General and GAO have also reviewed Federal Student Aid (FSA) loan and grant disbursements that total approximately \$24 billion a year. A January 1997 IG report found that a significant number of student aid applicants reported incorrect information on their Federal financial aid applications, resulting in approximately \$177 million in Federal Pell grant overpayments in the 1995-1996 award year. A subsequent test match conducted by the

Department of Education and the Internal Revenue Service (IRS) found over \$300 million in erroneous Pell grant payments in the 2000-2001 award year. To prevent these erroneous payments from occurring in the future, the Administration has developed a legislative proposal that would allow the IRS to match the income reported on Federal student aid applications with income tax return data. This proposal, formally submitted to the Congress on August 9 of this year, is discussed in more detail later in this testimony.

GAO, using data mining techniques, found in its March 2002 audit that four schools had disbursed as much as \$3.4 million in Pell Grants to ineligible students (all to older students whose primary course of study was English as a second language (ESL), but who were not seeking degrees or certifications as required to be eligible for aid). Although this represented a small percent of FSA disbursements, the finding sheds some light on some of the underlying causes and internal control weaknesses that allowed these erroneous payments.

FSA has now begun to work with GAO to perform similar techniques to locate unusual concentrations of students with particular characteristics. It has determined what the norm is for concentrations of such students and has begun to determine what constitutes "abnormal" concentrations, which warrant further review. As a result of the audit, GAO referred 28 schools to the Department for further review due to abnormal disbursement patterns. However, in analyzing the complete disbursement data for these 28 schools and updating it for current years, FSA found that only six of the 28 schools had disbursement patterns that exceeded the normal range. More importantly, FSA used recent data to identify 20 schools (including the six identified with GAO) with abnormal disbursement patterns, and reviews have been scheduled or completed for these schools. With GAO and OIG assistance, FSA will continue to refine its methodology for

analyzing this information and conducting reviews at institutions where improper payments are suspected. In addition, cases where fraud and abuse are suspected are referred to the OIG.

The implementation of the Department's new Common Origination and Disbursement (COD) system allows a more systematic approach to this type of analysis. For example, a spike in enrollment of students above a certain age who are also non-citizens may indicate abuses in a school's ESL program. Beginning with the payment cycle for award year 2002-03, FSA has incorporated an edit that identifies all applicants 75 years of age or older. The ability to edit information will allow FSA to identify anomalies and disallow records pending analysis and documentation at schools that appear to have high concentrations of students with certain characteristics and take appropriate action through enhancing COD edits and/or investigative work at the schools.

Data Matches and Data Integrity. The results of the GAO audit largely supported our belief that, except for an area that requires a legislative solution, our current controls over student eligibility and disbursements to institutions are strong, and provide us with reasonable assurance that our objectives are being met. However, as the audit also demonstrated, there is always room for improvement.

FSA routinely conducts matches with the Social Security Administration (SSA) to ensure that applicants have valid Social Security Numbers (SSNs). In FY 2000, we enhanced our student eligibility edits by matching information supplied on the Free Application for Federal Student Aid (FAFSA) with the SSA's Death Master File to intercept attempts to secure Federal funding using a false SSN. That match has produced the following results thus far:

| | | |
|--------------|---------|-------------|
| - 2000-2001 | Matched | 1 record |
| - 2001-2002 | Matched | 76 records |
| - 2002-2003* | Matched | 150 records |

*through just the first 34 weeks of processing.

In addition, the Department's Central Processing System (CPS), which processes the FAFSA, performs pre-screening matches to ensure that applicants who are in default on Federal loans or who owe overpayments of Federal grant funds do not receive additional funds. Hundreds of millions of dollars of potential improper payments a year are averted because of those matches. The addition of the post-screening match allows us to identify additional students that potentially are not eligible for aid.

Also, the COD system now assists us in ensuring data accuracy across all our systems and programs. In previous years, when Direct Loans were originated, there was no match between the Direct Loan origination system and the student application system to ensure that data was accurate. This resulted in errors, with necessary corrections made after a loan was already provided to the servicing system. However, this year, with the implementation of the COD system, loan origination data provided by the schools is now matched with existing applicant data to ensure there are no data discrepancies so only applicants with valid SSNs receive loans, and correct data is captured in the initial loan origination records.

The Secretary has made getting the student financial assistance programs off the GAO list of "high risk" programs one of his highest priorities. The Department's commitment to continued internal control improvements in the FSA program delivery systems, such as the ones described above, are instrumental to the successful elimination of this designation.

Legislative Barriers

Our most important current initiative to curb erroneous payments and remove the student financial assistance programs from GAO's "high risk" list depends on congressional action. In 1998, as part of reauthorization of the Higher Education Act of 1965 (HEA), Congress authorized a data match with the IRS on student aid applicant data. However, because return information may not be disclosed to third parties unless authorized by the Internal Revenue Code of 1986 (IRC), the match described in section 484(q) of the HEA could not be implemented. Section 6103 of the IRC must be amended to allow for this critical verification.

In early June 2002, Treasury informally provided draft legislation to the Joint Committee on Taxation for technical review that would address this issue. The Director of OMB and the Secretaries of the Treasury and Education formally transmitted the proposed amendment to Congress on August 9, 2002. Staff from Treasury and Education are currently identifying and agreeing on processes and procedures to support the match, including necessary follow-up with applicants and schools in a manner that, once authorized, will protect the privacy of the taxpayers in accordance with the proposed legislation.

Implementation of the proposed data match between the Department and IRS has the potential to ultimately eliminate over \$300 million in erroneous payments in the Federal Pell Grant Program each award year. I urge Congress to consider this proposal in the near future.

Summary

I believe our efforts thus far demonstrate our firm commitment to address the overall problem of erroneous payments and to complete necessary

improvements in the administration of the Department's programs. We have strengthened internal controls throughout the Department. We are monitoring use of purchase cards aggressively. We will be improving our analysis of travel expenditures shortly. In our student financial assistance programs, we have a very clear focus on integrating systems; maintaining critical accountability while improving customer service; demonstrating a balanced, yet accountable, school monitoring approach; and addressing quickly suspected anomalies in the payment of funds to recipients in order to prevent a return to past practices.

We will periodically report on our progress in reducing erroneous payments to OMB and the Congress, as well as announce any future plans for controlling improper payments.

I would like to close by saying that our management improvements have clearly put us on a very positive course toward our goal of becoming a model agency of management and program excellence. I come before you today with confidence to assure you that corrective actions are being well targeted throughout our Department.

This concludes my testimony, and I would be happy to answer any questions you may have.

Mr. HORN. Thank you very much.

We have a statement to put in the record by the Honorable Mark W. Everson, the Deputy Director for Management, in the Office of Management and Budget. Without objection, that's put into the record.

[The prepared statement of Mr. Everson follows:]

**Testimony of the Honorable Mark W. Everson
Deputy Director for Management, Office of Management and Budget
before the
Subcommittee on Government Efficiency, Financial Management,
and Intergovernmental Relations
Committee on Government Reform
U.S. House of Representatives**

October 3, 2002

I am pleased to be able to provide the Subcommittee on Government Efficiency my testimony on the problem of erroneous payments made by the government. This is a longstanding problem that has demanded appropriate attention for some time. As you know, the President campaigned on a promise to bring financial discipline to the Federal government. Reducing erroneous payments is a big part of that and a key component of his management agenda. Although this testimony focuses on the Administration's efforts to reduce erroneous payments, the Office of Management and Budget also has an aggressive approach to ensuring the integrity of travel and purchase cards used by Federal employees. Other Administration witnesses will testify before your Subcommittee on these efforts.

Reports by the General Accounting Office, agency Inspectors General, and agencies' own financial statements show that erroneous payments are a government-wide problem. We are making every effort to track and reduce them in order to save the taxpayers billions of wasted tax dollars. Agencies are taking concrete steps to ensure that the right payments go to the right beneficiary. To make dramatic reductions in erroneous payments, it will take a combination of administrative and legislative actions, as well as the cooperation of the innumerable third parties, our partners in administering many Federal programs.

In August 2001, President Bush released his management agenda. In that agenda, it was announced that OMB would establish a baseline of erroneous payments and work with agencies to establish policies and practices to reduce them. We asked every Federal program that made more than \$2 billion in benefit payments to submit with their budget an estimate of their erroneous payments and goals for reducing them.

Chairman Horn, you are one of the chorus of people who have been asking agencies to report their erroneous payments. Senator Fred Thompson also consistently asked that agencies report estimates of payments made improperly. This is the first Administration to require agencies to do this. I am proud of the progress we have made.

The General Accounting Office has reported that in the past, just a few agencies bothered to report estimated erroneous payment rates in their financial statements. Since we asked agencies to begin submitting erroneous payment rates with their budgets, the number of programs that can report this information has more than tripled.

Following is a chart showing the major agencies that have established erroneous payment rates and the most recent data they have reported:

| Programs | Erroneous Payments | |
|--------------------------------|----------------------|---------|
| | Amount (in millions) | Percent |
| Medicare -Fee-for Service | \$12,100.0 | 6.30% |
| Earned Income Tax Credit | 9,200.0 | 29.35% |
| Housing Subsidy Programs | 3,281.0 | 17.38% |
| Unemployment Insurance | 2,251.3 | 9.21% |
| SSI | 1,590.0 | 5.73% |
| Food Stamps | 1,340.0 | 8.66% |
| OASI | 1,339.0 | .36% |
| Disability Insurance | 1,313.0 | 2.22% |
| Medicare -Cost Reports | 493.0 | 2.7% |
| Student Assistance Pell Grants | 336.0 | .71% |
| FEHBP | 241.0 | 1.14% |
| Federal Retirement | 167.0 | .35% |
| Student Aid - External | 65.0 | .14% |
| Military Retirement Fund | 18.6 | .05% |
| Student Aid - Internal | 13.3 | .03% |
| Commodity Loans | 7.6 | .09% |
| Federal Transit Administration | 5.5 | .09% |
| (7a) Business Loan Program | .3 | 1.9% |
| Airport Improvement Program | .3 | .01% |
| FEGLI | .2 | .01% |

I caution you not to aggregate these figures. In the past, agencies reported in their financial statements a mixture of estimated erroneous payment rates and actual erroneous payments. We are now requiring

agencies to provide an erroneous payment rate based on a statistical sample projected to the universe of payments made. For the FY 2004 budget process underway, we have further refined our guidance to agencies, requiring them to distinguish between overpayments, underpayments, and total erroneous payments, as well as to define the methodology they used to come up with their error rate, in their budget submissions. This will assure consistency in the error rates reported by agencies.

GAO has reported erroneous payments of around \$20 billion for each of the past three years. But as you can see, these figures confirm that government-wide erroneous payments are much greater than just those reported in agency financial statements. And we've only begun to get a handle on what erroneous payments are at agencies that have a harder time coming up with estimates.

For those agencies that have measured erroneous payments before, the Bush Administration is requiring that they get serious about preventing erroneous payments from going out on the front end. One example is Medicare. Medicare reported a continued decrease in its erroneous payment rate from 6.8 percent in 2000 to 6.3 percent in 2001. In 1996, the error rate was 14 percent.

The Department of Health and Human Services (HHS) Inspector General credits the Centers for Medicare and Medicaid Services (CMS) for their efforts. "CMS has worked with provider groups . . . to clarify reimbursement rules and to impress upon health care providers the importance of fully documenting services. . . . In addition, due to efforts by [the Centers for Medicare and Medicaid Services] and the provider community, the overwhelming majority of health care providers follow Medicare reimbursement rules and bill correctly."¹ But even 6.3 percent is \$12.1 billion a year, Mr. Chairman. So we must do better.

The Centers for Medicare and Medicaid Services are undertaking a new project, the Medicare Comprehensive Error Rate Testing (CERT) program, to refine its estimate of erroneous payments in the Medicare program. The CERT program will produce national, contractor specific, provider type, and benefit category specific paid claim error rates. The results from this effort will be used not only to calculate the paid claim error rates, but also to help the Centers for Medicare and Medicaid Services formulate corrective action. It promises to improve the administration of the Medicare program by both improving customer service and reducing waste.

¹ "Improper Fiscal Year 2001 Medicare Fee-for-Service Payments," Health and Human Services Inspector General, Report Number A-17-01-02002, February 15, 2002.

The Food Stamps program is also one where we have a good historical baseline with which to measure progress to reduce erroneous Food Stamps payments. And again, the error rate is declining. The national Food Stamps error rate fell from 8.91 percent in FY 2000 to 8.66 percent in FY 2001. This is the lowest error rate ever. Even with this decline, this still represents \$1.3 billion in over and under payments. So, the Food and Nutrition Service, under the able leadership of Eric M. Bost, Under Secretary for Food, Nutrition, and Consumer Services, is taking an aggressive approach to reducing erroneous payments in the Food Stamps program.

Despite a reduction in the national Food Stamps error rate, certain states in 2001 had exorbitantly high error rates. For instance, California had an error rate of 17.37 percent, and Michigan had an error rate of 13.9 percent. Under Secretary Bost is working with those states to ensure they put policies and practices in place to prevent erroneous payments from being made in the first place. But he is also holding all states with high error rates accountable, levying cash sanctions authorized by law to recover Federal dollars erroneously paid. If implemented properly, the Food Stamps Quality Control program can improve the administration of Food Stamps. Unfortunately, the recently enacted Farm Bill inhibits the ability of the Food and Nutrition Service to hold accountable those states with high error rates. This is an example of Congressional action working against our goal to improve the integrity of Federal program payments. In the past, the Department of Agriculture could simply take the rate at which a state makes erroneous Food Stamps payments, compare it to the national average erroneous food stamps error rate, and assess cash sanctions against states that were above the national average. But unfortunately, past Administrations failed to do this, neglecting to establish accountability. Still worse, the Farm Bill artificially lowers the statistically determined error rate for each state, and it only allows the Department of Agriculture to assess penalties against a state when it has exceeded the national error rate by 5 percent for two years in a row. And it reduces the penalties that can be assessed.

We are requiring all agencies to implement erroneous payment reduction programs like those at Medicare and Food Stamps. But for agencies that have traditionally not bothered to check whether they were disbursing Federal funds appropriately, an estimate of erroneous payments can be a difficult thing to come up with.

Although the Department of Health and Human Services has a mature method for estimating erroneous payments in the Medicare program, the same is not true for Medicaid, Temporary Assistance for Needy

Families, State Children's Health Program, or other programs it administers. Unlike Medicare, Medicaid is a program that is financed with and administered by the states. Under broad Federal guidelines, each state establishes a Medicaid plan that outlines eligibility standards, provider methods, and benefit packages tailored to the needs of its citizens. Because Medicaid encompasses more than \$225 billion in payments each year, assessing the risk of erroneous payments is critical.

The Centers for Medicare and Medicaid Services are currently administering a pilot program to test core methodologies for measuring erroneous payments in the Medicaid program. HHS plans to expand the pilot from 12 states in FY 2003 up to 25 states in FY 2004. Following these pilots, the Centers for Medicare and Medicaid Services expects to have a tested Medicaid methodology (for both fee-for-service and managed care payments) that the Federal government could mandate for use by every state. That methodology could then be modified, as appropriate, for use in other programs.

Even without an erroneous payment rate, HHS is taking steps to prevent erroneous payments in most of the benefit programs it administers. To assess risks to its programs, HHS reviews audits conducted by the HHS Inspector General and the General Accounting Office. In addition, the Department reviews audits conducted pursuant to the Single Audit Act. With this information, the Department is developing strategies to prevent erroneous payments and enforce program requirements.

The School Lunch Program is another program not administered directly by the Federal government. The Food and Nutrition Service administers the School Lunch Program through grants to state agencies. Each state agency, in turn, enters into agreements with school districts for local level program operation and delivery of needed food benefits to eligible children. Although there is no national error rate, data from a variety of sources analyzed by the Food and Nutrition Service indicates that the number of ineligible recipients could exceed 20 percent. Therefore, the Food and Nutrition Service has recently proposed that schools report the results of activities undertaken under current regulations to verify the eligibility of program applicants. State agencies would then consolidate, analyze, and report such information to the Food and Nutrition Service. This first ever nationwide analysis of the eligibility verification process in the School Lunch Program will provide valuable assistance to the Food and Nutrition Service and the states to address weaknesses in program eligibility certification, a concern for the School Lunch Program, as well as for the many education programs that use free and reduced price meal data to target a much larger pool of resources. Additionally, the agency has initiated pilot projects to test alternative procedures for establishing program eligibility that may be helpful in preparing

legislative proposals for improving program integrity for Congressional consideration during the reauthorization of this important nutrition program.

Our ongoing efforts to reduce erroneous are bearing fruit. In many Federal programs, when citizens apply for benefits, the information is verified by checking the information against numerous sources of information. The Department of Labor – each week – draws small random samples of paid claims, verifies all information pertinent to eligibility, and determines whether the payment amount accorded with state law and policy. The Social Security Administration is increasing the number of cases it reviews to ensure that the nondisability factors of eligibility continue to be met, and that payments to beneficiaries are correct. This increase -- by 9 percent in FY 2003 -- is expected to lead to substantial improvements in payment accuracy rates.

No matter how hard we try administratively to address erroneous payments in many Federal programs, Mr. Chairman, the solution is often a statutory one. Programs are sometimes created with such cumbersome parameters that it would be impossible to administer without substantial risk of erroneous payments. Agencies could benefit from added tools to prevent erroneous payments, which they are often precluded by statute from using.

The Department of Housing and Urban Development (HUD) program provides rental subsidies to millions of Americans. But HUD overpays hundreds of millions of dollars in low-income rent subsidies due to the incomplete reporting of tenant income, the improper calculation of tenant rent contributions, and the failure to fully collect all outstanding rent. HUD has committed to a goal of a 50 percent reduction in these erroneous payments by 2005. HUD has developed a comprehensive strategy to address this issue, including updated program guidance and training, as well as automated tools for tenant interviews and rent calculations. But HUD needs tools to meet its aggressive goals to reduce erroneous rental subsidy payments.

HUD needs access to more information so that it can verify tenant income. One such source of information is the New Hires Database, which provides timely information that can be used to corroborate what applicants are telling housing officials is their actual income. But HUD needs statutory authority to gain access to this information, which is in the custody of HHS, and the Administration will propose that such authority be enacted.

The Administration has also proposed similar statutory authority for the Department of Labor to allow it to verify on a more timely basis when recipients of unemployment benefits have returned to work. With erroneous unemployment insurance payments at approximately \$2.3 billion, this new data sharing tool is likely to save the American taxpayer hundreds of millions of dollars annually.

One longstanding barrier to improving a program's payment integrity lies with Financial Student Aid at the Department of Education, which is unable to access tax information to verify the income of applicants for Federal financial aid. Congress already enacted this explicit authority of the Department of Education to access tax information to verify the income of applicants for Federal financial aid. However, because there was no amendment to the Internal Revenue Code, officials at the Department of the Treasury and the Department of Education couldn't share the required information. So this Administration has submitted legislation to cure this problem and give the Department of Education this critical data-sharing tool.

These are just a few of the statutory proposals that either have already been transmitted by the Administration to Congress or are under active consideration. As we identify statutory barriers to reducing erroneous payments, we will work to have them removed. It will take Congress' active cooperation to remove them.

Benefit programs aren't the only ones that make erroneous payments. The General Accounting Office and agency Inspectors General identify billions in contract overpayments annually. The Administration was pleased to sign into law the authority to implement recovery auditing government-wide. This common sense private sector technique examines all contract payments to determine the extent of things like duplicate payments; errors on invoices; payments for items not received; mathematical or other errors in determining payment amounts and executing payments; and the failure to obtain credit for returned merchandise.

This week, the Administration released draft guidance to agencies on how we recommend they implement this new law. If done correctly, recovery auditing can be a tool that can help agencies identify erroneous payments made, reveal why they were made, and prevent erroneous contract payments in the future. In addition to just employing recovery auditing, however, the Administration's guidance instructs agencies to implement management improvement programs, the purpose of which is to take the information gleaned from a recovery audit program, as well as other audits, reviews, or

information that identify weaknesses in an agency's internal controls, and ensure that actions are undertaken to improve the agency's contract payment process.

Erroneous payments are a major weakness in program administration across the Federal government. We are making an overall effort to improve the government's financial management. But this Administration is making every effort to ensure that we track them and work to reduce erroneous payments. The FY 2004 budget process will be just the second time we've asked agencies to provide us with erroneous payment estimates. The information submitted with the budget will show the many programs where we are making progress tracking and reducing erroneous payments. With our persistence and the continued cooperation of the Congress, this is one area where we will be able to demonstrate that we saved the American people some of their hard-earned dollars.

Mr. HORN. So we will move now to go to a few questions. It seems like things are improving, thank heavens.

Questions for Ms. Calbom, how would you characterize the responsiveness of these Departments to your requests for documentation concerning questionable purchase card transactions?

Ms. CALBOM. Education was very responsive in the work we did there. That's been, I guess about a year or so ago when we started our work, or maybe 18 months ago. We actually got all but about I think maybe 1 or 2 percent of the information that we asked for.

At HUD, we had a little more difficulty in getting the information that we needed, and that would be the support for transactions. I believe it was about 68 percent of the dollar amount of transactions that we asked for support for HUD was not able to provide. So we did have a little more difficulty. And just in general, there was, I think, a more cooperative spirit at Education. I think that is part of why you're seeing the differences in levels of documentation provided.

Mr. HORN. When you look at these various types of line of years going back probably 50 to 100 years in some cases, and HUD and Education, it's a newer agency, what was the role of the Inspector General in all the cases that you looked to them, and is a good part of the documentation put up by the Inspector General or what?

Ms. CALBOM. Actually, the Inspector General didn't have any role at all, typically, in providing the documentation, unless there happened to be transactions that their employees entered into. We pretty much dealt with either the CFO office or the program offices, in the case of HUD, to come up with our documentation. The Inspector General played a role in both agencies when we referred certain items to them for further followup and investigation.

Mr. HORN. And did that happen?

Ms. CALBOM. That has happened and is happening now, yes.

Mr. HORN. Are there any agencies you can name that they might serve as examples of best practices for reducing improper payments?

Ms. CALBOM. I think there are agencies where pieces of the agencies would serve as good examples for reducing improper payments. And of course, that's what your bill is trying to get more and more people to do. And actually, HUD has been one of the agencies, for their rental assistance programs, where they have been measuring the payments. And that, is key because you've got to know how much the problem is before you can figure out how many controls you need to put in place, and how much money you need to spend addressing the problem.

Also, Social Security Administration has been one that's been doing a fairly good job in measuring the improper payments and taking a lot of good actions in trying to address the improper payments in their big programs. Also, we do note in our executive guide, there are several States, actually, that have done an excellent job, Kentucky, Illinois and Texas are three States that we talk about in our guide that do a lot of data matching and that kind of thing, and some real good monitoring on their improper payments.

So there are a number of agencies that are doing some things. What isn't being done is really an across the board program that

has all of these components that I talked about, so that there is really a program that permeates entire organizations.

Mr. HORN. It was noted, Mr. Martin, that Education is missing a high number of computers acquired with purchase cards. Would you please elaborate on this, and also on your comment that there are indications of similar problems at HUD?

Mr. MARTIN. I didn't comment, Mr. Chairman, that there were similar problems at HUD.

Ms. CALBOM. I could comment on that, after you answer the original question.

Mr. MARTIN. We have implemented a new fixed asset inventory management system. I think that system should be fully implemented by the end of December. We have inventoried all of our computer equipment. I think practically all of that equipment has been accounted for.

Mr. HORN. Well, give me an idea of that. Is this a GS-9, a GS-12, 13, whatever, to supervise it?

Mr. MARTIN. That's conducting the inventory?

Mr. HORN. Yes.

Mr. MARTIN. We are using an outside contractor to conduct the inventory, and we do have probably GS-12s and 13s working with that contractor to help facilitate the completion of the inventory.

Mr. HORN. How long will that contractor be doing that?

Mr. MARTIN. The contractor should be wrapped up, Mr. Chairman, I would guess. I can get you an absolute date if you require that. But I think the contractor should be——

Mr. HORN. Tell us who it was, tell us how much it cost, how long will they be around, etc. And that will go at this point in the record.

[The information referred to follows:]

Answers to questions asked of Jack Martin, Chief Financial Officer, U.S.
Department of Education during testimony before the U.S. House of
Representatives, Committee on Government Reform's Subcommittee on
Government Efficiency, Financial Management and Intergovernmental
Relations on October 3, 2002

Question: Please provide the name of the contractor used in the computer inventory process. If multiple contractors were employed for various phases, describe each contractor's task and provide the following information for each:

- 1) the amount paid to each contractor
- 2) what work the contractor was paid to perform
- 3) when the work was completed or will be completed.

Answer: In early FY 2001, the Department of Education (ED) began a major effort to address the various problems with the computer inventory identified by the General Accounting Office (GAO) and the Office of Inspector General (OIG). We hired contractors to assist us in this work.

Management identified 3 major tasks necessary to achieve full accountability and a streamlined process for asset management within the Department:

- 1) Improve ED's asset management policies and procedures;
- 2) Centralize ED inventory responsibility within our Office of Management; and
- 3) Document detailed property management procedures for the entire process, from receipt to disposal.

The details of the various contractor contributions are as follows:

On August 28, 2001 ED issued a contract to KPMG/American Appraisal Associates (AAA) by Office of the Chief Financial Officer (OCFO) Purchase Order (PO)(ED-01-PO-1247- Mod #2) to perform an ED Asset Management Review and to provide recommendations on the entire asset management program. The initial award was for \$113,920.27; it was subsequently amended to add another \$20,000 for total of \$133,920.27. The services KPMG/AAA provided include the following:

- 1) Completing a comprehensive validity check of the Department's most current inventory count as well as a review of draft policy and procedures to determine their accuracy and to determine if the Department has sufficient control over its assets;

- 2) Conducting a detailed analytical review of existing draft policies and procedures to assess coverage;
- 3) Reviewing relevant documentation, interviewing selected staff and performing testing to determine if policies and procedures were being followed and to identify areas requiring updated policies and procedures; and
- 4) Developing a "Risk Factor Table" that would estimate the anticipated error or loss if inventory count is not performed annually.

These tasks were instrumental in identifying the deficiencies in the Department's asset management operations. Based on the recommendations and findings of the KPMG/AAA review, the ED Office of Management submitted a Procurement Request, ED000M-02-000078, on February 22, 2002 for the amount of \$176,000.00 to OCFO to modify PO Number ED-01-PO-1247. The purpose of this procurement was to obtain the assistance of KPMG/AAA to perform full asset management reconciliation, to establish new asset management policies, procedures and processes for property management oversight and control, and to address all other deficiencies identified in their prior work.

Using the results and recommendations provided, Department staff, with the assistance of KPMG/AAA, completed a thorough overhaul of the asset management program. Today the Department has successfully completed and implemented all of the recommendations provided by KPMG as follows:

- 1) New policies and procedures for Asset Management operations in the Department were developed. These procedures and policies were immediately provided to asset management staff with directions on full accountability compliance. The new policies and procedures were in place as we conducted the FY 2002 inventory for the Department.
- 2) Department staff and KPMG/AAA contractors facilitated extensive discussions in the development of the new Policy and Procedures through a series of coordination meetings with all staff and management involved in the asset management process to ensure that all relevant input was obtained and discussed.
- 3) Department staff and KPMG/AAA prepared and delivered training on the new policies and procedures to Asset Managers and Executive Officers in the Department.
- 4) Department staff and KPMG developed a Detailed Inventory Plan for use by the Department in the conduct of its annual inventory.
- 5) Department staff and KPMG/AAA conducted an extensive review of Asset Software Systems, including performing a current market review of Commercial Off-the-Shelf (COTS) packages, and completed a thorough evaluation of the best of these asset systems to identify those that were fully compliant with Federal Managers' Financial Integrity Act (FMFIA) requirements with the intent of future purchase and installation.
- 6) Department staff and KPMG developed key performance metrics to identify and achieve baseline accuracy and compliance of Asset Management Processes.

- 7) Department staff and KPMG aligned the new policies and procedures to match these requirements across the Department's organizational functions and business processes.

This work served as the foundation for the new asset management process, procedures, and system that the Department has now in place as it proceeded to conduct the FY2002 inventory.

The Department initiated its FY2002 annual inventory in August 2002. Configuration Inc. was awarded an Inventory Management Contract (ED-02-PO-2421) in the amount of \$153,072.00 to conduct a Department-wide FY2002 Physical Inventory of Accountable Property. They completed their actual count on September 20, 2002 and submitted the raw data file to the Department.

The Department is presently reconciling the raw data file to the universe of accountable assets to identify new purchases, disposals, transfers, etc., and expects to complete the final reconciliation of the universe by October 30. Upon completion, a clean universe file will be provided to OCFO for the Department's auditor to test.

The Department's new long-term process for managing its accountable assets is now firmly in place and provides the necessary safeguards to ensure strong management and oversight to sustain our internal controls. A description of this process is provided as follows:

- 1) The Department controls the purchase of IT assets by permitting only individuals authorized to expend funds for this purpose to do so. Within our principal offices, the Executive Officers are the designated authorized individuals. We purchase our equipment primarily through bulk-buy through the Office of Chief Information Officer (OCIO) and after approval by the Contracts Office (CO) and the assignment of barcodes by the Office of Management (OM); where individual purchases are necessary it is still mandated that these follow the same process and procedure in obtaining approvals through CO and OCIO, as well as the necessary barcode placement in the purchase order.
- 2) The Department records its new inventory upon purchase and inputs that information into the asset management system – establishing an initial inventory record in the system;
- 3) The Department requires asset managers to appropriately store, secure and account for any items received until the items are assigned to an individual by name in the asset management inventory system;
- 4) The Department has increased physical security to account for all the inventory storage areas in use in the Department;
- 5) The Department has already initiated quarterly testing of purchase orders in our principal offices to ensure that all ordered items were received and all received items are recorded as inventory correctly;
- 6) We now take continuous appropriate steps to account for any items deemed unlocatable at each phase of oversight; and,

- 7) We currently perform an annual physical inventory conducted by outside contractor to verify accuracy of assets at the desks of employees and we will move to conducting additional cyclical inventories to supplement the annual inventory for the FY2003 cycle.

We issued new policies and procedures in draft in June 2002 as guidance, and direction to the FY2002 annual inventory, in order to hold our employees accountable in all asset management activities. We also requested our staff to recommend improvements to these policies, procedures and processes and to identify areas that required further attention as they conducted the FY2002 inventory. We intend to issue these procedures in final by October 30, 2002

The Department intends to undertake additional measures to strengthen its asset management process following completion of this year's inventory. As previously mentioned, we have concluded preliminary research on asset management software systems available off-the-shelf and analyzed those that comply with stringent FMFIA requirements. We intend to make a selection on a suitable system in the near future, implement that system quickly, and convert our existing staff-developed system to the new system selected. We also intend to hire 4 contract employees to work in-house to supplement existing staff to provide additional staff support necessary to manage and oversee the Department's assets and process.

Mr. MARTIN. OK. They should be complete, I think, by the end of November, no later than that. And I will get you the name of the contractor and—

Mr. HORN. How much they're getting paid and how long and for what.

Mr. MARTIN. OK. I will provide that information.

Mr. HORN. Because you know, these contractors come in, they go out and you do it for one audit, and if you don't do that, the whole thing goes back.

Mr. MARTIN. I think at Education we're very sensitive to that problem.

Mr. HORN. The question is, if they're really a fixed asset, as you say, we've got to have some sort of structure in there so it doesn't come every month, every quarter, every half year, every budget year, and have to have all this be spread out again.

Mr. MARTIN. The system that we're implementing will track our purchases and disposals, so that we will have good balances that we will be able to use in our financial statements.

Mr. HORN. You indicated something earlier—would you please elaborate on not just the computers, but what else a person can use with not thinking about it, and did any of them come from their own personal life that they want to do it with that Government card, and did you find much of that?

Mr. MARTIN. Mr. Chairman, I'm not quite sure I understand the question.

Mr. HORN. Well, let me give you an example. We started in on this in the U.S. Navy in San Diego. It was unbelievable. I mean, hundreds of people were out spending the taxpayers' money. And we want the U.S. Attorney to move in on them. So fraud is what we're talking about. And we ought to be serious about it.

So in one case down there, one of the worst, the Navy somehow palmed that person off here in the Pentagon, in the Army. I couldn't believe it. I said, what kind of idiocy is this. Senator Grassley and I sent a letter several months ago to Secretary Rumsfeld, we gave him about 800 names. You can start going to them. And he was just livid. He's got a task force over in the Pentagon now, the Secretary is beginning to move very quickly and quietly and try to get the message to everybody, "Hey, this is important, do something about it."

So I'm just curious, what's your strategy, and whether it's one person or ten people or something, is it worth doing?

Mr. MARTIN. We just implemented a table of penalties that applied to any employee that is discovered to be using either travel cards or purchase cards improperly. I think right now we've identified, since 1999, there are 58 employees that have been subject to formal disciplinary action as a result of mis-use of travel cards. And we have another 38 recently that we are reviewing with no actions concluded for mis-use of purchase cards.

So in any case, the penalties have been communicated to the employees. They have been essentially reviewed with our union representatives, and the union has agreed to our table of penalties. We are vigorously enforcing penalties where there is any indication of mis-use of travel or purchase cards.

Mr. HORN. What are the types of sanctions?

Mr. MARTIN. They can range from a temporary suspension of the use of the cards to termination from the Department. And that's the range that's shown in the table of penalties.

Mr. HORN. Has anyone been put out of the Department?

Mr. MARTIN. I believe one person has been terminated, Mr. Chairman, and I will get that information to you.

Mr. HORN. It will go at this point in the hearing.

[The information referred to follows:]

Answers to questions asked of Jack Martin, Chief Financial Officer, U.S.
Department of Education during testimony before the U.S. House of
Representatives, Committee on Government Reform's Subcommittee on
Government Efficiency, Financial Management and Intergovernmental
Relations on October 3, 2002

Question: You have briefly described the table of penalties the Department of Education implemented recently to use in dealing with purchase card and travel card abuse. Have you terminated any employees, or taken any other action as the result of purchase card or travel card abuse to reinforce the message that if an employee abuses purchase or travel cards, there will be penalties? Please provide a copy of the table.

Answer: In August 2002, the Department revised its Table of Penalties to specifically include purchase and travel card misuse to highlight our increased emphasis on identifying and penalizing misuse of these privileges. (These sections are provided below.)

TABLE OF PENALTIES FOR STATED OFFENSES Appendix A PMI 751-1

| Nature of Offense | 1 st Offense | | 2 nd Offense | | 3 rd Offense | |
|--|-------------------------|-------------------|-------------------------|-------------------|-------------------------|---------|
| | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum |
| 23. Offenses related to Government purchase charge card: | | | | | | |
| a. Carelessness or neglect resulting in administrative non-compliance with program policies. | Reprimand | 5-day suspension | 5-day suspension | 30-day suspension | Removal | |
| b. Intentional non-compliance with administrative program policies. | 2-day suspension | 14-day suspension | 14-day suspension | Removal | Removal | |
| c. Misuse of purchase card | 5-day suspension | 30-day suspension | 30-day suspension | Removal | Removal | |

| Nature of Offense | 1 st Offense | | 2 nd Offense | | 3 rd Offense | |
|---|-------------------------|-------------------|-------------------------|---------|-------------------------|---------|
| | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum |
| 24. Offenses related to Government travel charge card: | | | | | | |
| a. Misuse of card | Reprimand | 14-Day Suspension | 10-Day Suspension | Removal | Removal | |
| b. Delinquency in payment | Reprimand | 14-Day Suspension | 10-Day Suspension | Removal | Removal | |
| c. Misuse of card AND delinquency in payment | 5-Day Suspension | 30-Day Suspension | 30-Day Suspension | Removal | Removal | |

Please note, however, that even prior to amending the table of penalties to specifically address purchase and travel card abuse, the Department took action against abusers. Since July 2001, at least 9 employees who made or approved purchases that were either inappropriate or had insufficient documentation, were counseled. When we took action to remove one employee who used a purchase card inappropriately, the individual resigned.

When resolution of the situation requires repayment of funds, the Department employs: 1) a lump sum payment, 2) mandatory salary offset for repayment, or 3) a voluntary repayment plan with a negotiated time period based upon the circumstances existing in each individual case.

Thus far in 2002, 19 cases have been referred to our Office of Management, Human Resources Division, for formal supervisory follow-up. One additional case, wherein an employee inappropriately used a purchase card, was referred to the Office of Inspector General for further investigation and resolution.

In addition, our Inspector General is currently investigating an allegation wherein Department employees were allegedly involved in a scheme to obtain personal household furniture by using their government-issued credit cards. One employee and one former employee were arrested by ED OIG and FBI special agents, following an indictment handed down by a federal grand jury for the District of Columbia. The indictment charged the pair with 8 counts of conspiracy, theft of government property and false statements. One was further indicted for witness tampering. They were also charged with using their government-issued credit cards to pay contractors for work they did not perform, for which they purportedly received kickbacks.

We have the following data on travel card misuse cases between January 2001 and September 2002: 2 employees were counseled, 2 were admonished, 12 were reprimanded, 20 were suspended, and 3 were removed or resigned. (7 cases are pending.)

It is too early to tell whether the inclusion of purchase and travel cards in the Table of Penalties will have the desired effect of reducing misuse and abuse of government issued credit cards. We are hopeful that increased employee awareness of the specific penalties for card abuse, combined with the knowledge that we are taking adverse action against employees who continue to break the rules, will reduce the number of instances that occur. We recognize that reviewing and improving internal controls is a ongoing task, and the Department intends to remain vigilant in this area .

Mr. HORN. Now, Ms. Antonelli, you've got a handful, no question about it. Of all of these agencies, that's why you're there, and that's why Congress has put in Inspectors General and the Chief Financial Officer, the Chief Information Officer, all of them are very important. They can't just sit in their office, they've got to go and find out how this system works in HUD or Education or Agriculture, whatever it is.

So what can you do to educate us as to what's happening, so we don't have to go through this every year?

Ms. ANTONELLI. Well, in the time that I've been at HUD, and the example that I presented on the travel card, I think there's a tremendous amount that we can do, in my opinion, in a relatively short period of time to address many of the issues that have been raised by GAO. I believe we've already taken significant steps to tackle the two specific issues that GAO has raised today with respect to its work at HUD.

In the case of the purchase card program, we will be doing many of the similar things that we had done in the case of travel cards. I do believe that by the time 1 year from now, if you are asking us about what we've done at HUD in terms of our purchase card program, I'm confident that we will be able to come back to you with a very positive story. Because this kind of issue, along with any of these other types of financial management issues, are a very high priority for Secretary Mel Martinez to address.

It is given monthly attention within the Department. All the assistant secretaries are fully engaged. They will be receiving reports on people in their program offices who hold these purchase cards, what levels they're approved for use of a purchase card. There will be training of staff who have purchase cards. In instances where we discover abuse of the use of purchase cards, we will take appropriate disciplinary action. As in the case of travel cards, we are reviewing the policies and procedures that are in place. We will review the course of disciplinary actions that can be taken to make sure they are in place, and that they are communicated clearly to staff. And again, to the extent that we identify problems, we will take appropriate action.

I believe that we can address many of the concerns. Documentation we've already taken steps to address. The splitting of purchases is another area where, to the extent that we more adequately train card holders as well as approving officials, review who the card holders are, review who the approving officials are, we should be able to more effectively, through training, identify who these officials should be, and through the use of automated systems, through working with Bank One that manages the purchase cards, be able to make significant steps to identify in real time as opposed to the paper and manual reporting that could take as much as a month or more, more quickly identify these kinds of problems when they occur.

We were all very disturbed to see what GAO had uncovered. Again, I believe that I speak not only for myself but for the Secretary and my colleagues, the assistant secretaries, that we take this very seriously and will move very rapidly to address it.

In addition, GAO has said that it has reviewed our remediation plan, it still thinks that it can be improved. We agree, and we will

continue to work with GAO and with OMB and the IG in the days and weeks ahead and look for their additional feedback and assistance to further strengthen our remediation plan that we will aggressively implement in 2003. We would be more than happy to report or submit that plan to the committee once we have the feedback and agreement from all parties that they feel comfortable with that plan.

Mr. HORN. You mentioned the assistant secretaries. It rang a bell with me. How is the management situation in HUD? Does it work with a weekly or monthly deputy secretary and in the room are the assistant secretaries?

Ms. ANTONELLI. That's correct.

Mr. HORN. And any under secretaries floating around?

Ms. ANTONELLI. Deputy assistant secretaries do attend those meetings as well. But it has been a priority from as long as I've been there, day one, with the Secretary and the Deputy Secretary that communication and making sure a culture of accountability is established, that it permeates the organization, is a very high priority. And those monthly meetings are a very good vehicle for the Deputy Secretary to communicate these types of concerns fairly rapidly to the senior team. And the senior team works very well together and in turn works with their staffs to address these kinds of issues.

So we're very happy and we're committed to seeing the type of improvements we saw in travel cards with purchase cards as well. Again, I'm very confident that we can achieve that same level of improvement in a very short period of time.

Mr. HORN. Well, I hope it works. What happens to the employees in your Department that if they are caught using their cards in properly, in other words, what are the types of penalties? We've, I think, gone with that.

Ms. ANTONELLI. I think the penalties that Education, that Mr. Martin had mentioned, are not dissimilar from the ones that we would employ at the Department of Housing and Urban Development. Anything from reprimand to dismissal from the position, depending on the severity of the offense. In the case of travel cards, for example, early on we discussed, we sat down internally with our general counsel, asked for them to review the procedures, the disciplinary actions that were currently on the books to make sure that they were satisfactory, whether or not they needed to be strengthened. Our general counsel had reviewed it, said those were satisfactory. To the extent we identified problems, we could then take those actions.

We have not, to my knowledge, dismissed anyone at this time. But certainly to the extent that we have some problem in the future that we identify, I can assure you that we would be aggressive in addressing it.

Mr. HORN. Well, do you find that the assistant secretaries really care about this and under them are the real working bit of HUD or Education or Agriculture, whatever, and the question is, you can talk about it at the top and it doesn't mean a thing because you've got 12 different layers and several thousand people. So how are you going to get to that? It really takes the Secretary, the Deputy Secretary, to go after it.

Ms. ANTONELLI. Well, another way that the emphasis on improved financial performance is communicated throughout the Department, we have these monthly meetings led by the Deputy Secretary. Our Deputy Secretary and Secretary, unlike previous Secretaries and Deputy Secretaries, have made working with our field offices a very high priority, making it one Department, not headquarters versus field, but an integrated Department. Many of these monthly management meetings that we have don't simply focus on headquarters. Every month they then go out to the field and meet with the field and communicate these messages to our field offices.

Our Secretary and Deputy Secretary have, to the best of my knowledge, pretty much been to every region, probably more than once, to probably almost every field office. So it's very important that these messages are communicated, not just by the assistant secretaries, the Secretary and the Deputy Secretary, in headquarters, but two-thirds of our Department is in the field. They are using these purchase cards. This kind of message gets carried out to the field on a regular basis. These management meetings are done not just in headquarters, but in the field.

Mr. HORN. Well, besides e-mail or whatever, do you ever swap between field and Washington for a day or two, so they understand what a region does? Because often people don't, believe it or not, they just don't know. Because that's been their career, a lot of the career people just remain in Washington.

Ms. ANTONELLI. Right.

Mr. HORN. And that's where part of the problems are. Are we getting people back and forth so they know what everybody's doing and why?

Ms. ANTONELLI. I believe that has very much been a message that's been communicated by the Secretary and Deputy Secretary. Again, that the field cannot be forgotten, it is an extremely important part of the ability of the Department to execute its programs and our ability to manage those programs well. So everything that we're talking about here in terms of improving financial performance, the issues of erroneous payments, is a message that's not carried just in Washington, but it is carried to the field. And an effort to have the folks in Washington get out to the field and see what is being done in the field, where they are really where the rubber hits the road, and the execution of our programs, and similarly our field folks certainly come into Washington.

Mr. HORN. In order to, and this is directed at both HUD and Education, the order to manage the problem of improper payments, you must first understand the size of the problem. In the future, how do you plan to measure the amount of improper payments that your Departments are making?

Ms. ANTONELLI. In the case of HUD, our rental housing assistance area, one of the areas that's identified as high risk by GAO, it is by far the largest area of expenditure in terms of HUD's budget. We have the \$2 billion estimate of erroneous payments. That has been a very, very, very high priority for this Department, this administration, to continue to improve those estimates. We will do another estimate, re-estimate, in 2003 of the extent of the subsidy overpayments, under-payments, net overpayment in the rental housing assistance area. We have a very detailed plan of action

that we've developed to reduce those overpayments. We have a 50 percent reduction target by 2005. We have interim targets, we hope 15 percent in the next year, 15 percent in 2004, and then ultimately 50 percent by the time we reach 2005.

The estimation is extremely important. GAO is certainly right in that regard. In our other areas, we will certainly do what we can to identify where there are erroneous payments, estimate it to the extent that we can. But again, by far our largest area is the rental housing assistance, and we are focusing a tremendous amount of resource, time and energy in trying to do that right and to actually accomplish our goal, finally, within the next couple of years.

Mr. HORN. Let's take that as an example. Tell me what happens when the client gets so much, and then they have extra left over that they shouldn't have had? How do you see this?

Ms. ANTONELLI. In the case of rental housing assistance, it's the process by which the public housing authorities, project owners and agents estimate the amounts of subsidies that need to be paid. Because we have to work through so many intermediaries, several thousand, there's quite a challenge. We have very complex rules for determining the amounts of the subsidies and there's often errors that are done by those who actually have to do the subsidy determinations. In addition, we have issues related to the tenant.

Mr. HORN. Give me an example of subsidies and how you deal with them, and where does the improper aspect come in?

Ms. ANTONELLI. The amount of subsidy that a family, an eligible family or individual would be entitled to, there has to be a determination of what that subsidy amount is. It has to be based on the amount of income that family holds. There are types of exclusions and deductions to determine the amount of rent, and the amount that has to be subsidized of that rent.

It's a very complex process and we need to do a better job of educating public housing authorities about how to go about doing those calculations, so that they do them more accurately. At the same time, the individual or the family in terms of presenting income information sometimes makes errors. They may under-report their income. There's a variety of different reasons why the calculations may be erroneous.

So from our perspective, we need to do a lot in the way of additional program guidance and training. We're developing a rent calculator, something that is just more computerized, that makes it much easier for someone to enter the data and do the calculations, rather than for it to be a manual exercise that's much more prone to basic mathematical mistakes.

Anything that we can do in terms of education guidance, the use of technology, to make the subsidy calculations more accurate, so that we can reduce the levels of error. So there are many different things that we're going to be needing to do and to develop over time. And also, our communication efforts with the public housing authorities and other stakeholders, to help them understand what we're trying to do. Obviously to the extent that we could reduce the level of erroneous payments, we're able to serve a greater, larger population of people who are eligible for benefits. So ultimately, that's a great motivator for us to reduce the level of erroneous payments. And I think our stakeholders see those benefits.

Mr. HORN. Do you find the housing people in the county or the city need education and how do you educate them? Have you had various types of panels for them or what?

Ms. ANTONELLI. The effort within the Department is led by our Assistant Secretary for Public and Indian Housing.

Mr. HORN. I'm not talking about within HUD now, I'm talking about their clients.

Ms. ANTONELLI. I understand. It's the Public and Indian Housing, along with Office of Housing, working together, certainly have plans in place to do greater outreach and greater communication efforts to work with stakeholder organizations to talk more about this effort and the directions in which we want to go. Because I think ultimately, information and communication is one of the steps in managing improper payments and that's extremely important. The degree to which we do that well is going to have a significant impact on our ability, ultimately, to succeed.

Mr. HORN. Is there an inventory up in HUD as to what kind of housing we have put up and invested the taxpayers' money?

Ms. ANTONELLI. Is there an inventory—

Mr. HORN. Inventory, yes.

Ms. ANTONELLI. Of housing?

Mr. HORN. Yes.

Ms. ANTONELLI. Yes, to the best of my knowledge. Absolutely.

Mr. HORN. Well, I'll give you an example. Four years ago, one of the cardinals was looking at the housing situation. When he got to the city, they couldn't find the housing. And yet the special authority or the city or whatever had simply given them the money and they ran and never even put a brick on the ground. So is that the Inspector General's role, the Chief Financial Officer, or we can always use GAO?

Ms. ANTONELLI. Well, certainly GAO obviously helps us identify those kinds of problems. But certainly we do have these inventories of our properties. If there's a specific example, we'd be more than happy to look into that and get back to you about it to see what the issue was, perhaps where the problem is. I certainly would assume that the type of example—

Mr. HORN. It wasn't under this administration. It was about 4 to 10 years.

Ms. ANTONELLI. Well, we certainly don't want it to be an example in this administration. Again, we'd be happy to respond to any specific situations that you might be aware of, and look into it in more detail.

Mr. HORN. Well, how do you work out these situations, you're the Chief Financial Officer, with the Inspector General? How does that work out?

Ms. ANTONELLI. Certainly from my perspective as the CFO at the Department, and the Secretary and the Deputy Secretary and HUD's leadership team are all in agreement that we want to and believe that we do have a very good working relationship with our Inspector General. And again, as is the case with the General Accounting Office, much of the work that they do, the audits that they conduct, the investigations, obviously supplement the work that we do, highlight areas of vulnerability that allow us to turn around and to develop plans of action to address problems.

So we have a very good working relationship with the IG. I believe we've just finished a third semi-annual reporting period where we've reached management decisions on all outstanding audit findings. Previously, that was never done, in previous administrations. So I think that reflects how much of a priority we've made it in this administration to work with the IG to address audit findings, come to management decisions on how we're going to address those findings. So it's been a very, very high priority for the Department to work very closely with the GAO as well as the Inspector General.

Mr. HORN. Now, let's get back to the General Accounting Office, and Ms. Calbom. You've noted that there are various practices that we ought to be using on what you and the Controller General have called the best for reducing improper payments. Upon what you've heard what else ought to be tagged on that hasn't come up yet?

Ms. CALBOM. I think again, at both HUD and Education, they're doing some good things in some areas. But what I think needs to happen there as well as at all Federal agencies is, it needs to be something that encompasses the entire organization. I think people are starting to do that in the Federal Government. But as I said in my testimony, it takes money to do this. But what people have found in the study we did, and we went to Australia and the United Kingdom and several other places, they found that the money they saved in implementing this kind of a strategy paid for the program itself. And as I said, when you're a steward of taxpayer money, I think it's absolutely critical that the public have trust in these agencies and that their money is being spent appropriately.

So it is going to take an up-front investment. It is going to take the support from the Congress, things like your bill and the President's management agenda. We're beginning to see more and more agencies addressing this issue. OMB is pushing this issue very hard with the agencies. And so it's beginning to happen. We just need to keep the momentum going now.

Mr. HORN. Very good. Are there any comments you want to add to the record that we haven't brought up, or you haven't, let us know, and we'll wind it up. Anything you want to add to it?

Ms. CALBOM. Mr. Chairman, I'd like to just add one thing. On a personal note, I want to thank you for all the efforts that you've made in improving financial management in the Federal Government. Certainly there have been tremendous improvements, and a lot of that is a result of these kinds of hearings that you've been holding, and your efforts in this area.

Mr. HORN. Thank you. I appreciate that.

I want to thank the people here on the Hill that have helped us with getting this proper-improper bit, because that is new to everybody. Bonnie Heald is the staff director, Henry Wray, senior counsel, Dan Daly, counsel, has been the person leading on this in particular, Dan Costelo, professional staff member, then Chris Barkley, the majority clerk, right over there, his hands are always full, and Ursula Wojciechowski, our new intern.

Minority staff, David McMillen, professional staff, Jean Gosa, minority clerk. And our court reporter was Mary Ross. Thank you very much.

With that, we are adjourned.

[Whereupon, at 3:25 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

